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T.C. Memo. 1986-282

UNITED STATES TAX COURT

HOLTSINGER, INC., Petitioner v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 23278-84. Filed July 7, 1986.

Held: Respondent may use the deficiency procedures to recover an erroneous refund and is not limited to a suit under section 7405. Held further, failure of respondent to deliver to petitioner a copy of executed Form 872 does not affect validity of waiver.

George W. Ericksen, for the petitioner.

James W. Clark, for the respondent.

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MEMORANDUM FINDINGS OF FACT AND OPINION

WHITAKER, Judge: This case is before the Court on cross motions for summary judgment pursuant to Rule 121.[1] Respondent by statutory notice dated May 17, 1984, determined a deficiency against petitioner in the amount of $38,122.56. The deficiency is in the amount of the personal holding company tax under section 541 based on respondent's determination that petitioner was for its fiscal year ended May 31, 1980 a personal holding company within the meaning of section 542(a).

The facts material to the disposition of each of the motions for summary judgment are the undisputed facts set out in the petition, the answer, the reply, and the cross motions together with affidavits attached to each of the cross motions and the exhibits attached to each affidavit. There is no dispute as to any material fact.

Briefly summarized the facts are the following. Petitioner is a Florida corporation with its office address in Tampa, Florida, at the time its fiscal 1980 tax return was filed and on the date of filing of the petition in this case. Petitioner's 1980 fiscal year tax return recognizes that it was a personal holding company. Petitioner attached to the return Schedule PH showing the computation of personal holding company tax in the amount of $38,122.56. This tax is also shown on Schedule J, and

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[1] All section references are to the Internal Revenue Code of 1954, as amended and in effect during the year in issue, and all rule references are to the Tax Court Rules of Practice and Procedure.

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was paid with the return. The return was timely filed on August 15, 1980. On April 9, 1981, petitioner filed an amended return on Form 1120X claiming a refund of the personal holding company tax which had been paid. On September 7, 1981, respondent refunded the personal holding company tax with interest from the due date of the original return.

On July 5, 1983, petitioner signed a Form 872 extending the period for assessment of any deficiency for its 1980 fiscal year to June 30, 1984. The Form 872 was signed by respondent's agent on July 8, 1983. The statutory notice was issued to petitioner on March 17, 1984, which date was prior to the expiration of the statute of limitations as extended by the Form 872.

Petitioner's position is that when respondent refunded to petitioner the personal holding company tax paid with petitioner's return, there was no deficiency in petitioner's income tax to which the Form 872 could have pertained or with respect to which a statutory notice of deficiency could be issued. Petitioner contends that respondent's sole remedy was a suit for recovery of an erroneous refund under the provisions of section 7405. Petitioner further contends that the statute of limitations on a suit for an erroneous refund has expired. Section 6532(b). Respondent argues that respondent is not limited to a suit under section 7405, that the deficiency procedures are applicable and respondent's statutory notice was timely issued.

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At the trial, petitioner raised a further issue which is that the Form 872 is invalid because respondent has not shown that a copy of the Form was transmitted by respondent to petitioner after its execution by respondent. By agreement of the parties, this issue is also before the Court.

Under Rule 121, a summary adjudication may be made "if the pleadings, answers to interrogatories, depositions, admissions, and any other acceptable materials, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that a decision may be rendered as a matter of law." Rule 121(b). The moving party bears the burden of proving that there is no genuine issue of material fact, and factual inferences will be read in a manner most favorable to the party opposing summary judgment. Jacklin v. Commissioner, 79 T.C. 340, 344 (1982); Espinoza v. Commissioner, 78 T.C. 412, 416 (1982). Since no genuine issue as to a material fact has been raised by either party, the matter may be determined in this summary fashion.

Petitioner seeks a determination that petitioner owes no tax recoverable through the issuance of a statutory notice whereas respondent asks that we sustain his determination that there is a deficiency in income tax due from petitioner for its 1980 fiscal year in the amount of $38,122.56. For the reasons indicated herein, we agree with respondent.

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Petitioner's principal authority is United States v. Wurts, 303 U.S. 414 (1938), as interpreted in later cases including Fansteel Metallurgical Corp. v. United States, 172 F. Supp. 268 (Ct. Cl. 1959) and Maryland Small Business Dev. Financing Authority v. United States, 4 Cl. Ct. 76 (1983). We have carefully examined these and other cases cited by petitioner. We do not agree that these cases cast doubt on the recent decisions of this Court which hold that the remedy under section 7405 is not exclusive. See Beer v. Commissioner, 733 F.2d 435 (6th Cir. 1984), affg. a Memorandum Opinion of this Court; Pesch v. Commissioner, 78 T.C. 100 (1982); Krieger v. Commissioner, 64 T.C. 214 (1975). We hold for respondent on this issue.

With respect to petitioner's second argument that the Form 872 is not effective in this case because there is no evidence that a copy of the Form after approval and signature on behalf of the Commissioner was sent to petitioner, we also hold for respondent. There is no requirement that a copy of the Form be served on petitioner after its execution on behalf of respondent. Findlay v. Commissioner, 39 T.C. 580, 587-588 (1962), affd. and revd. on other issues 332 F.2d 620 (2d Cir. 1964).

By reason of the above, petitioner's motion for summary judgment is due to be denied and respondent's motion for summary judgment is due to be granted.

An appropriate order will be entered.

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UNITED STATES TAX COURT

PERRY JACK PIERCE, JR., Petitioner v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 35381-84. Filed July 8, 1986.

Perry Jack Pierce, Jr., pro se.

Anne M. DiFonzo, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

TANNENWALD, Judge: Respondent determined the following deficiencies in petitioner's income tax, as modified after trial:

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Taxable Year Ending	Deficiency	Additions to Tax Sec. 6653(b)[1]	Sec. 6654(a)
12/31/80	$4,062.18	$2,031.09	$182.93
12/31/81	5,590.00	2,795.00	428.32

The Court having dismissed the case for lack of prosecution as to all issues as to which petitioner had the burden of proof, the only issue remaining for decision is the additions to tax for fraud under section 6653(b) as to which respondent has that burden. Welch v. Helvering, 290 U.S. 111 (1933); Rule 142(a) and (b).

FINDINGS OF FACT

Petitioner resided in Herkimer, New York at the time these proceedings commenced.

Petitioner filed Federal income taxes for the years 1977, 1978, and 1979 in which were reported wages from Brown-Randall, Inc. of $17,013.86 for 1977, $18,711.62 for 1978, and $24,371.81 for 1979.[2] In each of these years, the return showed an overpayment which was refunded.

Petitioner failed to file any Federal income tax return for either 1980 or 1981.

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1 All section references are to the Internal Revenue Code of 1954, as amended and in effect during the years in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure.

2 Other items in small amounts for interest, dividends and state and local tax refunds were also reported on these returns.

During part or all of the years 1980 and 1981, petitioner worked as a salesman for Brown-Randall, Inc. and received as compensation therefor $19,184.54 in 1980 and $20,744.67 in 1981. Petitioner was furnished Forms W-2 by Brown-Randall, Inc. with respect to such payments.

Prior to June 1980, petitioner had filed with Brown-Randall, Inc. an Employee's Withholding Allowance Certificate (Form W-4) in which he claimed married filing status with zero exemptions. In 1980 and again in 1981, petitioner filed Forms W-4 with Brown-Randall, Inc. in which he claimed that he was exempt from withholding; said Forms W-4 were false and were designed by petitioner to avoid withholding.

ULTIMATE FINDING OF FACT

Petitioner underpaid his Federal income tax for each of the taxable years 1980 and 1981 and a part of each such underpayment was due to fraud.

OPINION

When this case was called for trial on March 17, 1986 at Buffalo, New York, pursuant to prior notice to the parties, the Court initially gave its attention to a motion by respondent for an Order to Show Cause Why Proposed Facts in Evidence Should not be Accepted as Established. A hearing on that motion had been set by order of the Court, which was served on the parties on February 28, 1986. Petitioner was present when the case was called for trial and later on March 17, 1986, when the hearing on

respondent's motion was held. At that hearing, the Court ruled on respondent's motion and, to the extent that its rulings accepted certain facts as established, such facts have been so found.[3] Petitioner offered no substantive contentions to challenge respondent's proposed findings nor did he indicate to the Court that he had any such contentions or that he had offsetting deductions, exemptions, or credits against tax.

At the hearing on March 17, the Court set the case for trial on March 21, 1986. When the case was called for trial on March 21, pursuant to the Court's March 17 oral notice to the parties, respondent presented his evidence to establish the addition to tax for fraud. Neither petitioner nor any representative attended the March 21 trial. After the trial, the Court issued an order, dated March 27, 1986, in which it set forth respondent's revised determinations as indicated at the outset of this opinion, to which it attached a copy of respondent's trial memorandum and his covering letter to the Court and in which the Court indicated that it would enter a decision in these amounts

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[3] The record contains a request for admissions by respondent but does not contain any response by petitioner. Under these circumstances, petitioner is deemed to have admitted each matter covered by the request. Rule 90. However, the relevant matters appear to have been covered by the Court's rulings on respondent's proposed stipulation of facts. Consequently, the Court has not taken into account any deemed admissions. See also note 4, infra.

unless petitioner filed, on or before April 30, 1986, a response to respondent's trial memorandum and proposed decision. Petitioner has filed no response.

We now turn to the issues involved in respondent's determination of deficiencies for 1980 and 1981.

Initially, we note that petitioner's attack on the jurisdiction of this Court is utterly without merit. Rowlee v. Commissioner, 80 T.C. 1111, 1114 (1983). Petitioner's demand for "administrative level remedy and relief" must similarly be rejected; he has not furnished us with any basis which would justify our going behind the deficiency notice. Greenberg's Express, Inc. v. Commissioner, 62 T.C. 324, 327-328 (1974).

The Court's dismissal of the case for failure properly to prosecute disposes of the issues involved in the deficiencies and the additions to tax under section 6654(a). In any event, petitioner must be held not to have carried his burden of proof on these issues since he neither presented, nor sought to present, any evidence with respect thereto.[4] Welch v. Helvering, 290 U.S. 111 (1933); Rule 142(a). To the extent that his position rests on the proposition that compensation for services is not taxable income, it is rejected. Hansen v. United States,

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4 Petitioner's claim of privilege under the Fifth Amendment, even if valid, does not relieve him of his burden of proof. United States v. Rylander, 460 U.S. 752, 758-759 (1983); Steinbrecher v. Commissioner, 712 F.2d 195, 198 (5th Cir. 1983), affg. a Memorandum Opinion of this Court.

744 F.2d 658, 660 (8th Cir. 1984); Rowlee v. Commissioner, supra at 1119-1122. Similarly, we reject petitioner's contention that he was not a "taxpayer." United States v. Stillhammer, 706 F.2d 1072, 1077-1078 (10th Cir. 1983). Equally without merit is petitioner's contention that he was not paid in dollars. United States v. Rickman, 638 F.2d 182, 184 (10th Cir. 1980); Hatfield v. Commissioner, 68 T.C. 895, 897 (1977).

As to the fraud issue, respondent must carry his burden of proof by clear and convincing evidence. Rule 142(b). The existence of fraud is a question of fact based upon the record as a whole and, while fraud may not be presumed, it may be proved by circumstantial evidence. Castillo v. Commissioner, 84 T.C. 405, 409 (1985). We think respondent has met his burden.[5]

Petitioner filed returns in the years prior to 1980. Under these circumstances, his failure to file with respect to 1980 and 1981 "weighs heavily against him." Castillo v. Commissioner, supra at 409. The same can be said of his use of false W-4 certificates in order to avoid withholding on what was clearly taxable income. His frivolous claim that compensation for

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5 We have limited our analysis of the existence of fraud to those facts for which we find support in the record, beyond those deemed stipulated with respect to which petitioner claimed the Fifth Amendment privilege.

services is not taxable income, as a justification furnished to his employer at the time he executed such certificates, is no answer. Rowlee v. Commissioner, supra at 1125.

To reflect the foregoing,

Decision will be entered for the respondent.

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UNITED STATES TAX COURT

SAMUEL E. AND DAISY L. WEHR, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 28808-84. Filed July 8, 1986.

Samuel E. Wehr, pro se.

Michael L. Gompertz, Jr., for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

WOLFE, Special Trial Judge: This case was heard pursuant to the provisions of section 7456(d) of the Internal Revenue Code.[1]

Respondent determined a deficiency in petitioners' 1981 Federal income tax in the amount of $1,321.05. The sole issue for decision is whether petitioners are entitled to a residential

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[1] All statutory references are to the Internal Revenue Code of 1954, as amended and as in effect during the year in issue, except as otherwise noted.

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energy credit under section 44C(a)(2).[2]

Some of the facts have been stipulated, and those facts are so found. Petitioners resided in Woodbridge, Virginia, at the time of the filing of their petition in this case. They timely filed a joint Federal income tax return for 1981 with the Internal Revenue Service Center, Memphis, Tennessee.

Petitioners installed an "earth coil based heating system" in their home. This system includes the following components: (a) approximately 1,200 feet of plastic pipe buried underground and covered or surrounded by a layer of sand, (b) a pumping system (operated by electricity) and associated plumbing that circulates water through the pipe, (c) a heat pump consisting of a compressor, air handling unit, heat exchangers, refrigerant, and associated controls, (d) miscellaneous hardware for connecting the pipe to the heat pump.

The water circulating in the pipe is heated in the winter and cooled during the summer by the temperature of the ground. The ground temperature is at all times less than 50 degrees Celsius.

On their 1981 income tax return petitioners claimed a residential energy credit for the earth coil. No credit was claimed for the heat pump and associated air handling system. After further studying the statute covering renewable energy

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Section 44C has been redesignated section 23 by section 471(c)(1), Deficit Reduction Act of 1984, 98 Stat. 826. This change is effective for the taxable years beginning after December 31, 1983. Section 475(a), Deficit Reduction Act of 1984, 98 Stat. 847.

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source credits, petitioners believe the cost of the heat pump (but not the associated air handling system) should be included as part of the system.

Petitioners contend that their earth coil is solar energy property and that their heat pump is geothermal energy property within the meaning of section 44C, although these classifications are not in accord with regulations promulgated by respondent.

Section 44C (a)(2) allows an individual a credit against Federal income tax for qualified renewable energy source expenditures. A renewable energy source expenditure must be made with respect to renewable energy source property. Section 44C(c)(2)(A). Renewable energy source property includes property which transmits or uses solar energy or which transmits or uses energy derived from geothermal deposits. Section 44C(c)(5)(A)(i)

Section 1.44C-2(f)(1), Income Tax Regs., provides that solar energy property must use energy directly from sunlight. This section further provides that "Property which uses, as an energy source, fuel or energy which is indirectly derived from sunlight * * * such as * * * heated underground water is not considered solar energy property."

Petitioners' earth coil does not use energy directly derived from sunlight. In the summer, it is the lack of the sun's warmth that allows the earth coil to cool the residence. When the coil heats Petitioners' home in the winter, it uses heated underground

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water, a source of energy indirectly derived from sunlight according to respondent's regulations. Under the regulations the earth coil does not qualify as solar energy property.

Section 1.44C-2(h), Income Tax Regs., provides that geothermal property must transmit or use energy from a geothermal deposit having a temperature exceeding 50 degrees Celsius. The heat pump does not qualify as geothermal property under the regulations because it fails to use water which has a temperature exceeding 50 degrees Celsius.

Since petitioner's property is not property which transmits or uses solar energy or geothermal energy within the meaning of the applicable regulations, it is not renewable energy source property and the expenditures for its purchase and installation are not "qualified" and do not result in a credit for petitioners under section 44C.

Petitioners disagree and suggest that the regulations in question are invalid. Petitioners urge that they must be considered to have satisfied performance and quality standards for renewable energy source property under section 44C(c)(5)(D) and that therefore their expenditures must have been qualified and must result in a credit under section 44C. The argument is flawed because it is inconsistent with terms of the statute and implementing regulations specifically authorized by the Congress.

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Section 44C(c)(5) provides:

> (5) Renewable energy source property.--The term "renewable energy source property" means property--
>
> (A) which, when installed in connection with a dwelling, transmits or uses--
>
> (i) solar energy, energy derived from geothermal deposits (as defined in section 613(e)(3)), or any other form of renewable energy which the Secretary specifies by regulations, for the purpose of heating or cooling such dwelling or providing hot water or electricity for use within such dwelling, or
>
> (ii) wind energy for nonbusiness residential purposes,
>
> (B) the original use of which begins with the taxpayer,
>
> (C) which can reasonably be expected to remain in operation for at least 5 years, and
>
> (D) which meets the performance and quality standards (if any) which--
>
> (i) have been prescribed by the Secretary by regulations, and
>
> (ii) are in effect at the time of the acquisition of the property.

Section 44C(c)(5) includes four requirements which property must meet to qualify as renewable energy source property. Petitioners' argument focuses on the performance and quality standards. Section 1.44C-4, Income Tax Regs., entitled "Performance and quality standards," has been "reserved" for future use. Petitioners contend that the Secretary of Treasury

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has not fulfilled his statutory mandate[3] because no performance and quality standards have been prescribed. Petitioners believe that their system could meet any performance and quality standards that might be promulgated. They argue that the potential to meet all possible standards is sufficient to qualify their equipment as renewable energy source property.

Petitioners' position amounts to an argument that they need to satisfy only one of the four subparagraphs of section 44C(c)(5) and that satisfaction of the criteria of section 44C(c)(5)(D) should establish that their system is "renewable energy source property." On the contrary, each one of the four requirements of this section must be met in order for property to be eligible for the credit. Because petitioners' property does not meet the requirements of section 44C(c)(5)(A), it is not "renewable energy source property" regardless of whether the property might have met any performance and quality standards of section 44C(c)(5)(D) if such standards had been set forth in the regulations.

The performance and quality standards simply are not at issue from the plain meaning of the statute.

Moreover, the Secretary has been given broad discretion and authority in implementing the provisions of section 44C.

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3 Section 44C(c)(6)(A)(i) provides in pertinent part:

> (A) Criteria; certification procedures.--The Secretary shall by regulations--
>
> (i) establish the criteria which are to be used in (I) prescribing performance and quality standards under paragraphs (3), (4), and (5)* * *

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Olson v. Commissioner, 81 T.C. 318, 320 (1983). The legislative history explains that the Secretary "may promulgate regulations (in addition to those relating to performance and quality standards) which specify the solar, wind, and geothermal energy equipment qualifying for the credit." S. Rept. 95-529 (1978), 1978-3 C.B. (Vol. 2) 199, 232.

The Secretary has exercised his authority by prescribing the solar and geothermal equipment qualifications in the regulations which disqualify petitioners' equipment. This Court previously has upheld the validity of section 1.44C-2(h) of these regulations, specifically with reference to geothermal deposit temperature, in Peach v. Commissioner, 84 T.C. 1312 (1985) on appeal (4th Cir., Sept. 13, 1985); Rabenold v. Commissioner, T.C. Memo. 1985-309, affd. per curiam 786 F.2d 1177 (11th Cir. 1986); Reddy v. Commissioner, T.C. Memo. 1984-395, affd. per order (4th Cir., August 29, 1985).

For reasons discussed in detail in the Peach, Reddy and Rabenold cases, supra, and in Olson v. Commissioner, supra, the validity of section 1.44C-2(f) of the Income Tax Regulations also must be sustained as the regulations are legislative in nature and are not clearly inconsistent with the statute they implement. The requirement of the regulations that solar energy for purposes of section 44C refers only to energy derived directly from sunlight and not to energy indirectly derived from sunlight such as fossil fuel and heated underground water is a reasonable distinction for purposes of determining the meaning of the statutory term "solar energy."

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Petitioners' equipment does not qualify as solar or geothermal energy property under the applicable regulations, and petitioners are not entitled to a residential energy credit. Respondent is sustained.

Decision will be entered for the respondent.

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UNITED STATES TAX COURT

JIMMY JEFFERS AND PEGGY SUE JEFFERS, Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket Nos. 14588-83, 28952-83. Filed July 14, 1986.

Jimmy Jeffers, pro se.

Nancy W. Hale, for the respondent.

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MEMORANDUM FINDINGS OF FACT AND OPINION

WILBUR, Judge: In these consolidated cases, respondent determined the following deficiencies in petitioners' Federal income taxes:

Docket Number	Year	Deficiency
14588-83	1979	$1,226.91
14588-83	1980	1,843.00
28952-83	1981	5,807.00

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After concessions, the issues remaining for decision are:

(1) Whether petitioner-husband is entitled to employee business expenses, in excess of the amounts allowed by respondent, for meals and lodging incurred while he was away from his home in connection with temporary employment during the 1979, 1980, and 1981 taxable years.

(2) Whether petitioner-husband is entitled to a deduction of $700 in 1981 for work clothes and safety boots used in the workplace pursuant to section 162.[1]

FINDINGS OF FACT

Some of the facts have been stipulated. The stipulation of facts, supplemental stipulation of facts, and attached exhibits are incorporated herein by this reference.

Petitioners, who filed joint Federal income tax returns for the years 1979, 1980 and 1981, were residents of Clinton, Tennessee, when they filed their petitions in these cases.

Jimmy Jeffers (hereinafter petitioner) was employed as a pipe fitter during the years in question. He was employed away from his home in Clinton, Tennessee, for a total of 207 days in

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[1] Unless otherwise indicated, all statutory references are to the Internal Revenue Code of 1954, as amended and in effect for the years in issue.

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1979; 180 days in 1980; and 317 days in 1981. Petitioner claimed the following deductions in the amounts shown below in connection with his employment:

	1979	1980	1981
Cost of Meals	$2,820 ($12/day)	$ 3,120 ($16/day)	$ 5,389 ($17/day)
Lodging expenses	$3,995 ($17/day)	$ 5,070 ($26/day)	$10,144 ($32/day)
Automobile expenses	$3,527 (22,524 mi.)	$ 3,066 (15,597 mi.)	$ 1,654 (8,272 mi.)

The parties have agreed that petitioner traveled 12,313 miles, 10,000 miles, and 8,272 miles in connection with his trade or business in 1979, 1980, and 1981, respectively. The parties have further agreed that petitioner is entitled to deductions for automobile expenses in the amounts of $2,259.41, $2,000, and $1,654 in the 1979, 1980, and 1981 taxable years, respectively. In addition, with regard to the cost of meals, respondent allowed petitioner $2,070 ($10/day) in 1979 and $1,800 ($10/day) in 1980.

Petitioner has failed to provide any specific documentary evidence to substantiate his travel related expenses. In addition, he was unable to provide corroborative evidence, through his testimony, to establish with particularity the amount, time, place, and business purpose of his expenditures.

Petitioner also claimed a miscellaneous deduction in the amount of $700 for work clothes and safety boots purchased in 1981. The items consist of heavy denim jeans and high-top safety

boots. The boots in question were worn to protect Mr. Jeffers in the workplace and were not suitable for use outside the workplace.

OPINION

Issue 1. Meals and Lodging Expenses

Respondent contends that the travel expenses, in excess of those allowed by respondent, claimed by petitioners in connection with his temporary employment as a pipe fitter should be disallowed because petitioners failed to substantiate such expenses as required by section 274(d) and the regulations promulgated thereunder. We agree with respondent.

Section 274(d) provides, in pertinent part as follows:

(d) SUBSTANTIATION REQUIRED.--No deduction shall be allowed--

(1) Under section 162 or 212 for any traveling expense (including meals and lodging while away from home), * * * unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating his own statement (A) the amount of such expense or other item, (B) the time and place of the travel, entertainment, amusement, recreation, or use of the facility, or the date and description of the gift, (C) the business purpose of the expense or other item, and (D) the business relationship to the taxpayer of persons entertained, using the facility, or receiving the gift. The Secretary may by regulations provide that some or all of the requirements of the preceding sentence shall not apply in the case of an expense which does not exceed an amount prescribed pursuant to such regulations.

Section 274(d) is intended to supersede the doctrine set forth in Cohan v. Commissioner, 39 F.2d 540 (2d Cir. 1930), where it was held that the Court could estimate travel and entertainment expenses where documentary proof was lacking. "Section 274(d)

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contemplates that no deduction shall be allowed a taxpayer for such expenditures on the basis of such approximations or unsupported testimony of the taxpayer." Section 1.274-5(a), Income Tax Regs.[2]

Section 1.274-5(b)(2), Income Tax Regs., provides that the following elements must be proved with regard to each travel related expenditure:[3]

(i) Amount. Amount of each separate expenditure for traveling away from home, such as cost of transportation or lodging, except that the daily cost of the traveler's own breakfast, lunch, and dinner and of expenditures incidental to such travel may be aggregated, if set forth in reasonable categories, such as for meals, for gasoline and oil, and for taxi fares;

(ii) Time. Dates of departure and return for each trip away from home, and number of days away from home spent on business;

(iii) Place. Destinations or locality of travel, described by name of city or town or other similar designation; and

(iv) Business purpose. Business reason for travel or nature of the business benefit derived or expected to be derived as a result of travel.

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2 The Income Tax Regulations promulgated pursuant to sec. 274 have been uniformly approved by the courts. Dowell v. United States, 522 F.2d 708, 713 (5th Cir. 1975); Sanford v. Commissioner, 50 T.C. 823 (1968), affd. per curiam 412 F.2d 201 (2d Cir. 1969).

3 The regulations do allow the taxpayer to aggregate the amount of expenditures for his meals and incidental expenditures provided they can be established by reasonably adequate means. Sec. 1.274-5(b)(2)(i), Income Tax Regs.

Section 1.274-5(c)(1), Income Tax Regs., provides that a taxpayer must substantiate each element of the expenditures "by adequate records or by sufficient evidence corroborating his own statement." In order to satisfy the "adequate records" requirement of section 274(d), a taxpayer must contemporaneously maintain an account book or diary and must provide documentary evidence[4] (e.g., receipts, paid bills) which, in combination are sufficient to establish the amount, time, place, and business purpose of the expenditure. Section 1.274-5(c)(2)(i), Income Tax Regs.

Expenses incurred for lodging must be substantiated by documentary evidence regardless of amount. Section 1.274-5(c)(2)(iii)(a), Income Tax Regs. The regulations do not allow the aggregation of lodging expenses as they do for meals and other incidental expenses.

Section 1.274-5(c)(3), Income Tax Regs., provides the taxpayer with an alternative manner by which he can satisfy the substantiation requirements of section 274(d). If the taxpayer

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[4] According to sec. 1.274-5(c)(2)(iii)(b), Income Tax Regs.,

> [D]ocumentary evidence will be considered adequate to support an expenditure if it includes sufficient information to establish the amount, date, place, and the essential character of the expenditure. For example, a hotel receipt is sufficient to support expenditures for business travel if it contains the following: name, location, date, and separate amounts for charges such as for lodging, meals, and telephone. * * *

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fails to comply substantially with the "adequate records" requirements with regard to an element of an expenditure, he must establish such element--

(i) By his own statement, whether written or oral, containing specific information in detail as to such element; and

(ii) By other corroborative evidence sufficient to establish such element. [Section 1.274-5(c)(3), Income Tax Regs.]

In Buddy Schoellkopf Products, Inc. v. Commissioner, 65 T.C. 640, 644 (1975), this Court interpreted section 1.274-5(c)(3), Income Tax Regs., to require "specific evidence about the activities that gave rise to an expense." (Emphasis in original.) The corroborative evidence must "establish each statutory element--amount, time, place and purpose--of the expenditure with precision and particularity." Hughes v. Commissioner, 451 F.2d 975, 979 (2d Cir. 1971), affg. a Memorandum Opinion of this Court. The record in the instant case is bereft of such specifics.[5]

Petitioner provided no documentation regarding his specific travel and lodging expenditures. He neglected to maintain any account book or diary to chronicle his expenses. Petitioner

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5 We note that secs. 1.274-5(c)(4) and (5), Income Tax Regs., provide for a relaxation of the stringent substantiation requirements where exceptional circumstances prevent the taxpayer from being capable of conforming with the statute and regulations or where records are lost or destroyed due to circumstances beyond the taxpayer's control. Neither of these special relief provisions apply in the instant case. It is quite clear from petitioner's testimony that his inability to provide adequate substantiation of his travel related expenditures stemmed from his own neglect and inadvertence.

testified that he paid some of his lodging expenses by personal check, but that he no longer had any of the cancelled checks reflecting such expenditures. He also testified that he discarded the receipts that he often received from hotels and restaurants. During the trial, petitioner indicated that the amounts claimed on his income tax returns for lodging and meals were only estimates. Without question, his generalized and uncorroborated testimony did not provide the necessary detailed information as to the material elements of his travel-related expenditures.

It is clear from petitioner's testimony that he is a well-intentioned person. In addition, the amounts claimed by him with regard to both meals and lodging seem to be entirely reasonable in amount. Congress, however, has chosen to require detailed documentation as to all travel-related expenses incurred in a taxpayer's trade or business while away from home. Petitioner bears the burden of proof with respect to the deficiencies. Welch v. Helvering, 290 U.S. 111 (1933); Rule 142(a), Tax Court Rules of Practice and Procedure. He was unable to prove that he complied with the strict substantiation requirements of section 274(d) and, as previously noted, this Court is not at liberty to approximate what his expenses may have been. Accordingly, we hold for respondent on this issue.[6]

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[6] We note that sec. 274(d) and sec. 1.274-5(h), Income Tax Regs., authorize the Commissioner to establish rules pursuant to (footnote continued)

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Issue 2. Work Clothing and Boots

Petitioner claimed a miscellaneous deduction in the amount of $700 for work clothes and safety boots purchased in 1981. The items consist of heavy denim jeans and high-top boots. According to respondent, the clothing and boots purchased by petitioner were suitable for use outside the workplace and, therefore, do not constitute deductible expenditures.

In Roth v. Commissioner, 17 T.C. 1450, 1455 (1952), this Court held that no deduction is allowable for ordinary work clothing that is not in the nature of a uniform and that is not required to be worn as a condition of a taxpayer's employment. Generally, the cost of one's wardrobe constitutes a nondeductible personal expenditure within the meaning of section 262.[7] Clothing expenditures are, however, deductible as ordinary and necessary business expenses if (1) the clothing is required or essential in the taxpayer's trade or business; (2) the clothing

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(footnote continued from previous page)
which a taxpayer may elect to use a specified amount for meals while traveling in lieu of substantiating the actual cost of the meals. For meals purchased after December 31, 1982, Rev. Proc. 83-71, 1983-2 C.B. 590, allows $9 per day for travel that requires a stay of 30 days or more.

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SEC. 262. PERSONAL, LIVING, AND FAMILY EXPENSES.
Except as otherwise expressly provided in this chapter, no deduction shall be allowed for personal, living, or family expenses.

is unsuitable for personal use; and (3) the clothing is not worn other than during the course of taxpayer's employment. Yeomans v. Commissioner, 30 T.C. 757 (1958).[8]

Petitioner made no assertion that he was required by his employer to buy and wear these particular denim jeans, the cost of which he is seeking to deduct. The clothing was in no way unique and was generally adaptable to use outside the workplace. We will therefore deny petitioner's deduction for the cost of his jeans. Roth v. Commissioner, supra.

Petitioner testified that the nature of his work as a pipefitter made the use of high-top boots crucial to his safety in the workplace, and that furthermore certain of his employers specifically required their use. Because the boots in question were purchased and worn solely for petitioner's safety while at work, a deduction will be allowed for their cost. Cf. Bushey v. Commissioner, T.C. Memo. 1971-149.

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8 See also Gallagher v. Commissioner, T.C. Memo. 1979-412.

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To reflect the concessions made by respondent and our conclusions with respect to the disputed issues,[9]

Decisions will be entered under Rule 155.

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9 We note that there is also an issue as to whether the unemployment compensation received by petitioner in 1980 is taxable. The determination of this issue is dependent upon the application of sec. 85(a) to petitioners' adjusted gross income, as redetermined in light of this Court's findings. If the sum of petitioners' adjusted income, plus the unemployment compensation received by petitioner in 1980 exceeds $25,000, then petitioner's 1980 gross income will be deemed to include such unemployment compensation. Sec. 85(a). The amount of unemployment compensation included in gross income, however, is limited to the lesser of (1) one-half of petitioners' 1980 adjusted gross income (including the full amount of unemployment compensation) in excess of $25,000; or (2) the total unemployment compensation received in 1980.

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UNITED STATES TAX COURT

ESTATE OF ROBERT A. NESSELRODT, DECEASED
WILLIAM WHITLOCK, ADMINISTRATOR DE BONIS NON, Petitioner v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 24902-82. Filed July 14, 1986.

Harold D. Jones, for the petitioner.

Nancy W. Hale, for the respondent.

ORIGINAL

MEMORANDUM FINDINGS OF FACT AND OPINION

GOFFE, Judge: The Commissioner determined a deficiency in petitioner's Federal estate tax in the amount of $151,823.42. After concessions, the issues for decision are: (1) whether the decedent's debt to his ex-wife, which was to have been paid in nine annual installments, must be reduced to present value as of the date of death of the decedent; (2) whether a debt for an open account due to Nesselrodt-Campbell Gin Company in the amount of

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$127,969.88 that has not been paid, and which is barred by Missouri State law due to the failure of the claimant to submit a timely claim to the probate court, is allowable as a deduction to the estate of the decedent; (3) the determination of the fair market value of a 653.56 acre farm located in New Madrid County, Missouri, as of August 23, 1978; and (4) whether petitioner is entitled to special use valuation for the farm under section 2032A.[1]

FINDINGS OF FACT

Some of the facts have been stipulated. The stipulation of facts and accompanying exhibits are so found and incorporated by reference.

Robert A. Nesselrodt (hereinafter referred to as Robert or the decedent) died intestate on August 23, 1978.

F. J. Nesselrodt, Robert's father, qualified as administrator of the estate of Robert A. Nesselrodt (hereinafter referred to as the estate) in the Circuit Court of New Madrid County, Missouri, Probate Division. The notice of letters of administration of the estate was first published on September 15, 1978.

F. J. Nesselrodt died on January 7, 1981; William Whitlock was subsequently appointed administrator de bonis non of the estate

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[1] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954, as amended and in effect for the relevant years, and all rule references are to the Rules of Practice and Procedure of this Court.

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of the decedent and is the petitioner in this case. Petitioner's address as of the date of filing of the petition was Sikeston, Missouri.

On October 14, 1976, the marriage of Robert and Elizabeth Nesselrodt was terminated by divorce. The divorce decree directed Robert and Elizabeth Nesselrodt to perform the terms of a separation agreement dated October 12, 1976. The agreement that was incorporated in the decree required Robert to pay $80,547.01 to Elizabeth Nesselrodt. As of the date of the death of the decedent, the balance of the support to be paid to Elizabeth Nesselrodt totaled $54,000. The balance was to have been paid in nine annual payments of $6,000 on December 1 of each year. Elizabeth Nesselrodt filed a claim with the probate court for the entire unpaid amount, without any discount to allow for the payment schedule. The probate court allowed the claim and entered a judgment for the full amount of $54,000. Petitioner paid the claim with the approval of the probate court. The estate claimed a deduction on the estate tax return in the amount of $54,000 for the debt to Elizabeth Nesselrodt.

The estate also claimed a deduction in the amount of $127,969.88 for an account due to Nesselrodt-Campbell Gin Company. At the time of death of the decedent, 48 percent of the stock of Nesselrodt-Campbell Gin Company was owned by F. J. Nesselrodt, Robert's father and the original administrator of the estate of the decedent. An additional 48 percent of the stock was owned by Eva Nesselrodt, Robert's mother. No formal

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claim in any amount for the account due to Nesselrodt-Campbell Gin Company was filed in the New Madrid County probate proceedings of the estate within 6 months of the date of publication of the letters of administration nor was any claim filed up to and including the date of trial. The administrator during the first 6 months of administration, Robert's father, chose not to present the claim in order to avoid the sale of the Nesselrodt farm (discussed below), which was being operated by his grandchildren, including Robert's son and son-in-law. The claim has never been filed as a claim against the estate. However, the present administrator expects the grandchildren to eventually pay the debt. No part of the claimed debt had been paid as of the date of trial.

On the date of his death, the decedent owned a farm (hereinafter referred to as the farm or the Nesselrodt farm) in New Madrid County, Missouri, consisting of 653.56 acres, more or less, described as all of Section Seven (7), Township Twenty-Three (23) North, Range Thirteen (13) East of the Fifth Principal Meridian. On the decedent's estate tax return, the estate reported the fair market value of the 653.56-acre farm as $457,492, or $700 per acre. Approximately 604 acres, or approximately 92 percent, of the Nesselrodt farm is cropland. There are no improvements on the property other than two wells, only one of which is operable. The highest and best use of the Nesselrodt farm on August 23, 1978, was as a farm used for the production of corn, soybeans, wheat, and cotton.

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The Nesselrodt farm is located approximately two miles southwest of the intersection of Missouri State routes E and W. The Nesselrodt farm is bounded on both the north and on the south by county highways; a county highway splits the farm in a north-south direction and connects the county highways which bound the tracts on the north and south. All of these county highways are gravel. There are several unpaved field roads throughout the farm. Access to portions of the farm were from a gravel road that is impassable at certain times of the year.

The surrounding area is comprised primarily of farmland, most of which is either subject to floods or subject to periodic protracted wetness. The Nesselrodt farm is located one-half mile from the nearest major drainage ditch and is considered to be land that is subject to wetness rather than flood land. Land that is subject to wetness is inherently more valuable than flood land, assuming that the soil quality is similar. The farm is not level and contains many ditches and pockets of land where water stands after rain or during certain times of the year. There are two or three cypress trees, which are native to swamps, on the property.

The soil of a farm is a primary factor in determining productivity. Although loam soil is generally more valuable, clay soil can produce almost as well as loam soil if well-drained. The soil on the Nesselrodt farm is basically clay or gumbo, soil that is swampy part of the year and that cracks when it gets dry. The soil and the lack of the access to portions of

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the farm at certain parts of the year limit the property to only one crop each year. The crop yields are fair to average for wheat and grain sorghum and below average for cotton yields. The value of the crops growing on the farm as of Robert's death was $157,488.93.

The price of property in the area of the farm increased at a rate of between 8 and 10 percent per year between 1976 and 1980. Generally, properties containing less than 100 acres cost more per acre than the properties in excess of 100 acres. Other factors such as soil, drainage, and location are, however, more critical to a determination of value than the size of the parcel.

Methods used to value real property include income-capitalization approach, the reproduction-cost minus depreciation approach, and the comparative sales or market data approach. The income-capitalization approach tends to yield unrealisticly low valuations for farm property while the reproduction-cost approach is inappropriate for land without substantial improvements. The following is a list of comparable local property that was sold between February 16, 1976 and October 30, 1980, a period from approximately two and one-half years before Robert's death to two and one-half years after Robert's death:

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Grantor	Grantee	Date of Sale	Acreage	Price/ Acre
Allen-Davis Co.	Batterton	2/16/76	672	$ 650
Jackson	Roth	4/19/77	80	1,100
Frankle Estate	Schurenberg	10/30/80[2]	80	702
Robertson	First Royal Ent.	3/07/78	155	1,500
Minton	Ashley	6/02/78	47	851
Headlight Land Co.	Lawrence	6/30/78	536	1,650
Bauchman	Little River Land Co.	7/27/78	601	1,500
Yordy	Little River Land Co.	7/27/78	726	1,500
Grabiel	Hawkins	8/1/78	213	1,700
?	Shew	11/20/78	420	1,762
Bailey	Butler	2/02/79	308	1,375
Lewis	Freitag	3/01/79	240	1,400
White	Parker Bros.	4/27/79	383.59	2,170

The returns of three decedents who died in November 1977, December 1977, and March 1980, who owned property in Madrid County, the location of the Nesselrodt farm, were audited and values were agreed for the property in amounts of $510 to $600, $500 to $700, and $900 per acre respectively. The real estate that was valued in the course of these three audits was as close in location to the Nesselrodt farm as were most of the sales set forth above.

No request of any type for special valuation of the Nesselrodt farm under section 2032A was filed or made prior to December 11, 1980. Petitioner filed a "motion" for special use valuation of the Nesselrodt farm pursuant to section 2032A which was tendered on June 10, 1982. The "motion" bore only the signature of Harold D. Jones, attorney for the estate. The

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2 This sale occurred in 1977 but was not recorded until 1980.

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"motion" did not bear the signatures of the administrator, the administrator de bonis non, or of the persons in being who had an interest in the property, by which those persons signified consent to the application of section 2032A(c) in the event of disposition of the property or failure by the qualified heirs to use the property for the qualified use. Sec. 2032A(d)(2).

A Federal estate tax return was timely filed, including extensions of time to file, with District Director, Internal Revenue Service Center, Kansas City, Missouri, on August 22, 1979. The due date of the estate tax return after extensions was August 23, 1979.

On July 28, 1982, the Commissioner issued a statutory notice of deficiency to petitioner. As relevant to this opinion, the Commissioner determined that the deduction for the balance due to Elizabeth Nesselrodt under the agreement incorporated in the divorce decree should be limited to $38,146.80, the present value of the nine remaining installments. The Commissioner disallowed the entire claimed deduction for the account due to Nesselrodt-Campbell Gin Company on the grounds that it had not been paid. The Commissioner further determined that the fair market value of the Nesselrodt farm was $817,000, or approximately $1,250 per acre.

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ULTIMATE FINDING OF FACT

The Nesselrodt farm, as of the date of death of the decedent, August 23, 1978, had a value of $975 per acre for a total value of $637,221 for the 653.56-acre farm.

OPINION

The Commissioner's determination in his statutory notice of deficiency is presumptively correct, and petitioner has the burden of disproving each individual adjustment. Welch v. Helvering, 290 U.S. 111 (1933); Rule 142(a).

The first issue for decision is whether the deduction by the estate for the debt of the decedent to his ex-wife must be reduced from the amount actually paid to the present value of the debt as of the date of death of the decedent. Neither party to this action contests the validity of the claim nor the precise amount that would have been paid under the agreement as incorporated in the divorce decree. The disagreement is as to the amount deductible by the estate when it chose to pay the full value of the remaining payments immediately rather than either paying Robert's ex-wife over the 9-year period or discounting the amount due to its present value. The value of the taxable estate is determined by deducting from the value of the gross estate such amounts for claims against the estate as are allowable by the laws of the jurisdiction. Sec. 2053(a)(3). The estate deducted the full amount of the debt without discount pursuant to

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its payment to Elizabeth Nesselrodt, which was approved by the probate court. Section 20.2053-1(b)(2), Estate Tax Regs., provides:

> The decision of a local court as to the amount and allowability under local law of a claim or administration expense will ordinarily be accepted if the court passes upon the facts upon which deductibility depends. If the court does not pass upon those facts, its decree will, of course, not be followed. For example, if the question before the court is whether a claim should be allowed, the decree allowing it will ordinarily be accepted as establishing the validity and amount of the claim. However, the decree will not necessarily be accepted even though it purports to decide the facts upon which deductibility depends. It must appear that the court actually passed upon the merits of the claim. This will be presumed in all cases of an active and genuine contest. If the result reached appears to be unreasonable, this is some evidence that there was not such a contest, but it may be rebutted by proof to the contrary. If the decree was rendered by consent, it will be accepted, provided the consent was a bona fide recognition of the validity of the claim (and not a mere cloak for a gift) and was accepted by the court as satisfactory evidence upon the merits. It will be presumed that the consent was of this character, and was so accepted, if given by all parties having an interest adverse to the claimant. The decree will not be accepted if it is at variance with the law of the State; as, for example, an allowance made to an executor in excess of that prescribed by statute. On the other hand, a deduction for the amount of a bona fide indebtedness of the decedent, or of a reasonable expense of administration, will not be denied because no court decree has been entered if the amount would be allowable under local law.

This regulation provides a presumption of reasonableness for payment of a debt in satisfaction of a court judgment but the evidence must show that the court examined the merits of the claim. Petitioner has presented no evidence that the approval of the probate court, as demonstrated by its judgment approving the distribution of the estate including the payment to Elizabeth

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Nesselrodt, was based upon a contest of the validity of the claim that would support reliance upon this regulation. Sec. 20.2053-1(b)(2), Estate Tax Regs. We, therefore, cannot rely upon the judgment of the probate court as proof that the claim was a valid claim.

The judgment of the probate court is also not conclusive of the amount deductible by the estate if the approved payment is in excess of the amount of the claim that is allowable under local law. Sec. 20.2053-1(b)(2), Estate Tax Regs. Relevant portions of section 20.2053-4, Estate Tax Regs., provide:

> The amounts that may be deducted as claims against a decedent's estate are such only as represent personal obligations of the decedent existing at the time of his death, whether or not then matured, and interest thereon which had accrued at the time of death. * * * Only claims enforceable against the decedent's estate may be deducted. * * *

Respondent contends that the estate may not deduct an amount in excess of the present value of the debt, despite the judgment of the probate court, as the claim enforceable against the estate under Missouri State law was limited to the commuted value of the debt regardless of the judgment of the probate court. The amount that can be deducted is generally determined as of the time of death. Ithaca Trust Co. v. United States, 279 U.S. 151 (1929); Commissioner v. Estate of Shively, 276 F.2d 372 (2d Cir. 1960); Estate of Chesterton v. United States, 551 F.2d 278 (Ct. Cl. 1977). Deductibility is not conditioned upon a claim's allowance by a local court, but rather upon its enforceability under local law. Smyth v. Erickson, 221 F.2d 1, 3 (9th Cir. 1955). The

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applicable provisions under Missouri law for the payment of a debt payable in installments over a period of time are found in Mo. Ann. Stat. sec. 473.383 (Vernon 1956):

> The court may allow any claim filed against an estate, which is payable at a future day, at the then present value thereof, or the court may order the executor or administrator to retain in his hands sufficient funds to satisfy the same upon maturity; or if the heirs, devisees, or legatees offer to give bond to a creditor for the payment of his claim according to the terms thereof, the court may order the bond to be given in satisfaction of such claim.

Under this statute, the court is allowed to authorize payment of a lump sum in satisfaction of the claim, limited, however, to the present value of the claim. Otherwise, the claimant must await payment according to the terms of the obligation.

Although a claimed deduction may be rendered worthless or devalued by events occurring before the due date of the estate tax return, Estate of Chesterton v. United States, supra; Commissioner v. Estate of Shively, supra, petitioner cites no authority that permits aggrandizement of the claim beyond the commuted value that may be paid pursuant to Missouri State law and the Commissioner's regulations. Gratuitous approval by the probate court of payment by the administrator to a claimant in an amount greater than that permitted by State law does not increase the permissible deduction under section 2053. Sec. 20.2053-1 (b)(2), Estate Tax Regs. A limitation of the deduction to the commuted value established by the Commissioner's actuarial tables is appropriate. Estate of Lester v. Commissioner, 57 T.C. 503

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(1972). Petitioner has failed to prove its entitlement to a deduction in excess of the amount allowed by respondent. Rule 142(a).

The second issue for decision is the disallowance of the deduction for the claim of Nesselrodt-Campbell Gin Company in the amount of $127,969.88 against the estate of the decedent. Missouri law provides:

> [A]ll claims against the estate of a deceased person * * *, whether due or to become due, absolute or contingent, liquidated or unliquidated, founded on contract or otherwise, which are not filed in the probate division * * * within six months after the first published notice of letters testamentary or of administration, are forever barred against the estate, the personal representative, the heirs, devisees and legatees of the decedent. * * * [Mo. Ann. Stat. sec. 473.360 (Vernon 1986 Supp.).]

Where no claim for a debt due from the decedent is filed in the probate proceeding prior to the date upon which the claim becomes barred under State law, then generally no deduction for the claim is allowable to the estate. Estate of Hagmann v. Commissioner, 60 T.C. 465 (1973), affd. 492 F.2d 796 (5th Cir. 1974); sec. 2053(a)(3). Missouri law does permit payment of a debt of an estate for which no claim was filed during the 6-month period after publication if all interested parties consent, despite the fact that enforcement of the debt is barred. Mo. Ann. Stat. sec. 473.433[4] (Vernon 1986 Supp.). No payment of the claim at issue has been made up to the time of trial, however, nor has

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petitioner presented evidence that all interested parties would consent should the administrator attempt to pay the claim at such a late date.

The first notice of letters of administration was published on September 15, 1978. The administrator of the estate, who was also, with his wife, an owner of 96 percent of the creditor, Nesselrodt-Campbell Gin Company, chose not to present the claim representing the debt owed by the decedent to the company within the 6-month period after publication of the notice. The stated reason is that payment of the debt would bankrupt the estate requiring the sale of the Nesselrodt farm thus making it impossible for Robert's children (the original administrator's grandchildren) to continue to operate the farm. Petitioner urges that payment of the debt may yet occur when and if the estate becomes solvent. Although it is true that all of the interested parties may yet agree to pay the debt at a later date, the claim is no longer legally enforceable against the estate under Missouri law and is, therefore, not an allowable deduction under section 2053(a)(3). Estate of Hagmann v. Commissioner, supra.

The third issue for decision is the fair market value of the Nesselrodt farm as of the date of death of the decedent. The estate claimed a value of $457,492 while respondent determined a value of $817,000. Relevant portions of section 20.2031-1(b), Estate Tax Regs., provide:

> The value of every item of property includible in a decedent's gross estate * * * is its fair market value at the time of the decedent's death * * *. The fair market value is the price at which the property would

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> change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. The fair market value of a particular item of property includible in the decedent's gross estate is not to be determined by a forced sales price. Nor is the fair market value of an item of property to be determined by the sale price of the item in a market other than that in which such item is most commonly sold to the public, taking into account the location of the item wherever appropriate. * * * All relevant facts and elements of value as of the applicable valuation date shall be considered in every case. * * *

Valuation issues are inherently imprecise and capable of resolution only by a Solomon-like pronouncement. Buffalo Tool & Die Mfg. Co. v. Commissioner, 74 T.C. 441, 452 (1980); Messing v. Commissioner, 48 T.C. 502, 512 (1967). We must, however, apply the facts and circumstances test of section 20.2031-1(b), Estate Tax Regs., and establish the fair market value of the Nesselrodt farm, as the parties have failed to agree on the appropriate price per acre. The fair market value of property on any given date is a factual question and requires consideration and weighing of all relevant evidence in the record. Mauldin v. Commissioner, 60 T.C. 749, 759 (1973); Kaplan v. Commissioner, 43 T.C. 663, 665 (1965).

The Nesselrodt farm was subjected to three expert appraisals based primarily on the market data/comparative sales approach, resulting in valuations per acre of $750 (petitioner's expert), $1,050 (respondent's independent expert), and $1,270 (respondent's in-house expert) per acre. Petitioner's expert was thoroughly familiar with local facts and circumstances affecting

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the sales price of each of the comparable sales. Respondent's experts, although well-versed in matters of record, were at times unaware of local data that required adjustment of the sales price of comparable tracts.

Petitioner's expert used seven sales of local property as comparables to determine the appropriate fair market value of the Nesselrodt farm of 653.56 acres. Respondent's independent expert used eight comparable sales to determine the value of the Nesselrodt farm as $1,050 per acre. Respondent's in-house expert used seven comparable sales to determine the valuation of $1,270 per acre placed by him upon the Nesselrodt farm.

Only two of the sales of local property occurring within a period shortly before or after the date of Robert's death, August 23, 1978, were used by all three experts: the Bailey-Butler sale and the Grabiel-Hawkins sale. The adjusted values placed upon these two properties by the three experts were as follows:

Comparable Sales	Sales Price	Petitioner's Expert	Respondent's Independent Expert	Respondent's In-House Expert
Bailey-Butler	$1,375	$756	$1,063	$1,196
Grabiel-Hawkins	1,700	748	1,000	1,300

The sales price for the Bailey-Butler sale on February 2, 1979, was adjusted downwards by each of the experts but in varying amounts: 45 percent by petitioner's expert, 23 percent by respondent's independent expert, and 13 percent by respondent's in-house expert. Adjustment factors particular to the valuation process included: a sale of a contiguous tract only one month

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before for $950 per acre; an inflated price balanced by owner financing at below-market rates; slightly better drainage and soil than the farm; and its location on paved U.S. Highway 62 rather than gravel roads. Similarly, the Grabiel-Hawkins sales price was adjusted downwards as follows: 56 percent by petitioner's expert, 33-1/3 percent by respondent's independent expert, and 23.5 percent by respondent's in-house expert. Factors considered included: improvements consisting of a tenant house, an irrigation well, and grain bins; better drainage and soil; the sale of a one-fourth interest one year before for $800 per acre; the sale of a nearby 40-acre property within 2 months of the Grabiel-Hawkins sale at $851 per acre; and the fact that Hawkins sold, in part, to avoid a partition suit.

Each of the three experts adjusted the sales price per acre on each of the properties selected as comparable sales to account for differences between the compared property and the Nesselrodt farm. Examples of factors requiring adjustment included: different times of sale, different soil or drainage conditions, reasons for the sale (whether voluntary or forced), public nature of sale versus sealed bid auction, the relationship of the buyer to the seller (unrelated third party or, conversely, family or the same entity under a different name), accessibility, improvements, and the effect of owner financing. Each of the experts used differing groups of factors and applied different discount rates to account for the variations between the comparables and the Nesselrodt farm. We have carefully examined

all of the facts and circumstances before us as set forth by the expert witnesses and their reports and conclude that each of the reports has deficiencies. Petitioner's expert made substantial adjustments to each of the comparable sales which do not, in all instances, appear justified. Respondent's experts, however, were not fully conversant with local conditions and circumstances and failed to allow for the unusual nature of some of the comparable sales. Upon due consideration of the entire record, we find that the value of the Nesselrodt farm as of the date of death of the decedent, August 23, 1978, was $975 per acre for a total value of $637,221 for the 653.56-acre Nesselrodt farm.

The final issue for decision is whether the estate is entitled to special use valuation for the Nesselrodt farm under section 2032A. A preliminary requirement for such a valuation is the filing of a timely and complete election. The election must be made not later than the time prescribed by section 6075(a) for filing the estate tax return and must include an agreement, signed by each person in being who has an interest in the property to be specially valued in which the heirs consent to the imposition of additional estate tax upon disposition or failure to use the property in a qualified manner. Sec. 2032A(a)(1)(A), (B); sec. 2032A(b)(1), (2); sec. 2032A(d)(1), (2). Under section 6075(a), the estate tax return was due to be filed within 9 months after the date of the decedent's death or, in this case, on May 23, 1979. A request for extension of filing was requested and granted. The due date of the return, after extension, was

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August 23, 1979, a date which was significantly before the first communication of any sort, dated December 11, 1980, indicating a wish to elect special use valuation. No consent agreement has been filed up to an including the date of trial. Petitioner concedes that the estate failed to file a timely and complete election under section 2032A on or before August 23, 1979, but contends that the delay was due to its reliance upon an expected valuation for the farm in approximate agreement with the values determined in the audits of other taxpayers who had died at approximately the same time and who had owned nearby property. Petitioner's hope for a valuation in line with the values placed upon properties owned by other decedents does not, however, excuse failure to comply with the statutory requirement for a timely and valid election. As no valid election was timely filed, petitioner is not entitled to special use valuation for the Nesselrodt farm.[3] Sec. 2032A.

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[3] Petitioner's reliance upon the changes made to sec. 2032A by sec. 421(k)(5)(B) of the Economic Recovery Tax Act of 1981, Pub. L. 97-34, 95 Stat. 306, 314, and sec. 104(b)(4)(B) of the Technical Corrections Act of 1982, Pub. L. 97-448, 96 Stat. 2379, 2382, as permission for its belated election is misplaced. A preliminary requirement for the application of the liberalized provisions set forth by this statute was an election date that had expired no later than July 28, 1980, a date one year before the date upon which this estate was to have filed its election and consent agreement. See Estate of McCoy v. Commissioner, T.C. Memo. 1985-509.

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A number of items have been conceded by petitioner. To reflect the foregoing,

Decision will be entered under Rule 155.

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T. C. Memo. 1986-287

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UNITED STATES TAX COURT

JEROME B. FELDMAN AND WENDY FELDMAN, Petitioners
v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 9349-81. Filed July 14, 1986.

Jerome B. Feldman, pro se.

Patrick E. McGinnis, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

GERBER, Judge: Respondent determined deficiencies in and additions to the Federal income taxes of petitioners as follows:

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Year	Deficiency	Additions to Tax - Sec. 6651(a)[1]
1972	$ 6,882.79	-
1973	17,105.50	-
1974	19,803.99	-
1975	47,364.42	$9,506.42
1976	19,836.60	$3,892.00
1977	13,142.82	-

After concessions,[2] the sole issue for consideration is whether petitioners' quarter horse operation was an "activity not engaged in for profit" within the meaning of section 183.

FINDINGS OF FACT

Some of the facts have been stipulated and are found accordingly. The stipulation of facts and attached exhibits are incorporated herein by this reference.

At the time of the filing of the petition, Jerome B. Feldman (petitioner) was a resident of Delray Beach, Florida, and Wendy Feldman (Wendy) was a resident of Boca Raton, Florida. Petitioners were husband and wife at all times relevant to the proceedings. They filed joint returns for the years 1972 through

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1 All statutory references are to the Internal Revenue Code of 1954, as amended and in effect for the taxable years at issue.

2 Respondent conceded that petitioners did not receive a constructive dividend from Felbar Fabrics Corp. in 1975. Petitioners neither have presented evidence nor argued on brief that they sustained a sec. 1244 loss on Felbar Fabrics Corp. stock in 1977, or that the sec. 6651(a) addition to tax for late filing is inapplicable for 1975 and 1976. We accordingly find that petitioners have conceded these issues.

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1977. Petitioners' income tax return for the year 1975 was filed on April 6, 1978, and their income tax return for the year 1976 was filed on April 5, 1978.

Petitioners met in 1969. Drawn together in part by a common interest in horses, they married. The couple's interest in horses was shared by their four children, all of whom are products of a prior marriage.

Around 1970 petitioners vacationed at a riding camp in New York. Petitioners enjoyed the camp to such an extent that they decided to send their children to it. Before the end of the children's camp season petitioners purchased two horses, which were boarded at the camp.

Petitioners sent their children to the camp for the 1971 season. Petitioners visited the camp often and rode their horses. By the end of the 1971 season petitioners purchased two additional horses, one of which was a registered quarter horse. After the close of the 1971 camp season, petitioners' four horses were moved to a stable not far from their three-bedroom apartment in Fort Lee, New Jersey. The move was made so that the family could become more involved with the horses and avoid the lengthy drive to the camp. The horses, however, perished in a stable fire shortly after they were brought to New Jersey.

Petitioners had a developing interest in quarter horses and, after the fire, purchased two registered quarter horses, Killian's Rebel and Toad's May Lady. Petitioners exhibited their

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horses at shows and regarded these events as a good outlet for themselves and the children, who could compete and learn how to care for the horses. Petitioners continued to attend shows through 1972. Two of petitioners' children, Michele and Steve, showed the horses and in September 1972 a third quarter horse was purchased (Do It, Joe) for one of the children to show. At horse shows and at the ranches where petitioners' horses were stabled and trained, petitioners met people familiar with the operation of horse farms. From these experiences petitioners learned the rudiments of horse care and training and basic farm operations.

Petitioners, at a time when they had only a basic knowledge of how to operate a horse farm, decided to look at farm facilities that were for sale. Petitioners located farm property in Annandale, New Jersey, about 60 miles from New York City, and after showing the property to several friends involved with horses, petitioners purchased the land during September 1972. The property was a 135.5-acre operating horse farm with stalls, pastures, paddocks and basic farm equipment. Situated upon the property were a two-story, four-bedroom colonial frame house; a second, smaller dwelling unit; a carriage house; several barns; tack rooms and garages. The property also included a fully landscaped, 25-foot by 50-foot concrete swimming pool. The purchase price for the entire property was $500,000. Petitioners

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purchased the Annandale property as a residence and as a place to breed, raise, show and sell quarter horses. Petitioners called their horse farm Wenfel Farms.

At the time petitioners acquired the Annandale property, petitioner was president of and a 50-percent shareholder in Felbar Fabrics Corporation of New York City. In later years petitioner became an officer and part owner of two other New York City textile firms.

About the time petitioners acquired Wenfel Farms, petitioners purchased Madonna's Doll and King's Miss Lou as show or brood mares. Petitioners and their children moved to the farm during the fall of 1972. They brought their horses, then five in number, with them. In October 1972 petitioners purchased two additional show mares, Chick's April Fool and Sue's Missy Red. Prior to her acquisition, Sue's Missy Red had been shown and had accumulated show points so as to entitle her to "champion" status.[3]

On their tax return for 1972, petitioners, on a Schedule C (Profit (or Loss) From Business or Profession), reported no income from Wenfel Farms, and claimed deductions of $13,831.49 for a loss on its operation. Petitioners received and reported $97,550 in income from wages paid by Felbar Fabrics Corporation.

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[3] Sue's Missy Red and some of petitioners' other horses participated in American Quarter Horse Association shows. Horses in these events were entered in different classes and judged and awarded points on the basis of confirmation, gait and other characteristics. Horses with a certain number of points achieved champion status within the class in which they competed.

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In 1973 and continuing through 1976, petitioners followed an established routine on the farm. Usually four days a week, petitioner would leave the farm early in the morning and commute to his job in New York City; generally he would return late in the evening. The children would feed the horses in the morning before school. Wendy would then muck the stalls and exercise the horses. She would make certain that the farm had adequate feed and bedding and that the horses were clean and groomed. On some weekends petitioners would drive their horses to shows. At appropriate times during the year, petitioners would prepare and position their brood mares for breeding with their stallion.

Petitioners owned seven horses at the start of 1973 and they encountered problems with many of them. Do It, Joe had proven to be a poor show horse, and Toad's May Lady had not performed too well either. Madonna's Doll and King's Miss Lou also seemed deficient as show horses and were used as brood mares. During 1973 petitioners sold Do It, Joe and bought no horses. Petitioners knew that they needed help with their horses, and hired a local trainer to assist them.

On their tax return for 1973 petitioners, on a Schedule C, reported receipts of $1,926 from board paid by horse owners who kept their animals at Wenfel Farms and shavings sold as bedding material for horses. Petitioners claimed total deductions of $33,899.39, for a net claimed loss of $31,973.39 on the operation of Wenfel Farms. On a Schedule D (Capital Gains and Losses)

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petitioners claimed an $850 loss on the sale of Do It, Joe. In addition to their claimed losses from Wenfel Farms, there was reported $84,650 in income to petitioner from his business activity in the textile business.

Petitioners, during 1974, purchased three additional show mares: Suggar Sandy Bar, Fancy Feather and Dawn Eternal. Suggar Sandy Bar and Fancy Feather had accumulated show points to entitle them to "champion" status. Two fillies were born during 1974: Killian's Doll and King's Miss Rebel. During 1974, petitioners bred one of their mares with a stallion that had "champion" status and acquired a few cows to maintain their pastures and provide a source of revenue from the sales of calves. Petitioners also hired new trainers, a husband and wife team whom petitioners believed possessed great expertise. During 1974 petitioners' daughter, Michele, attended and competed successfully in many horse shows. Petitioners advertised horses and their farm in equine publications. Despite these developments, petitioners continued to have difficulty in selling horses. They did not sell a single horse in 1974. At the end of 1974 petitioners again changed trainers in the hope of increasing sales.

On their tax return for 1974, petitioners reported total farm receipts of $2,809 from Wenfel Farms. Most of the receipts were attributable to the boarding of horses for others; $350 came from the sale of a calf, and $125 from a prize in a horse show.

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Petitioners claimed total deductions of $49,021, for a net loss of $46,212. In addition to their claimed losses from Wenfel Farms, petitioner's income from business activity in the textile business was reported in the amount of $89,000.

During 1975 petitioners continued to attend horse shows. Three foals, all colts, were born to petitioners' mares during the year: Rebels Tusox, Payday Overdue, and Killian's Boy. Two mares, Madonna's Doll and Chick's April Fool, were sold.[4] Madonna's Doll had proven unsatisfactory as a brood mare, and Chick's April Fool did not have great success as a show horse. Petitioners experienced a number of other difficulties during 1975. Petitioner's textile business had problems, and he was forced to devote more time to it. Michele no longer wanted to show horses. The continuing high expenditures connected with the farm strained petitioners' marriage. For a short period of time Wendy left the farm, taking most of the horses with her.

For their 1975 taxable year petitioners, on a Schedule C, reported total receipts of $2,457 from selling calves and boarding horses. Petitioners claimed total deductions of $58,967, for a net loss of $56,510. On a Form 4797 (Supplemental Schedule of Gains and Losses) petitioners claimed, after depreciation and selling expenses, a $293 loss on the sale of Madonna's Doll, and a $725 loss on the sale of Chick's April

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4 One of the 1974 foals, Killian's Doll, may also have been sold.

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Fool. In addition to their losses from Wenfel Farms, there was reported income from petitioner's textile business activity in the amount of $96,050.

In 1976 petitioners continued to exhibit horses at competitive shows. In some ways, however, the operation of Wenfel Farms changed during the 1976 year. Petitioner's textile business went bankrupt and he spent all of his time at the farm, working at such tasks as training horses. Because he no longer had income from the textile business, petitioner put part of the farm property up for sale. Wendy began study for a real estate license in order to help market the farm property and supplement petitioners' income. Petitioners continued to have marital problems. Four more foals were born: Silvers Prince (a colt, later gelded), Pesky (another colt later gelded), Sue's Love Story (a mare), and an unnamed mare. Fancy Feather was sold at a loss during the year.

On their 1976 Schedule C petitioners reported $4,200 in receipts from Wenfel Farms: $3,000 from the sale of two foals, Killian's Boy and the unnamed mare born in 1976. Petitioners claimed total deductions of $49,778, for a net loss of $45,578. In addition, on a Form 4797 petitioners, after taking into account depreciation and selling expenses, claimed a $600 loss on the sale of Fancy Feather. The reported sales price of Fancy Feather was $8,500, $2,500 less than its purchase price. There

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was also reported income from petitioner's textile business activity in the amount of $46,220, and salesman's commissions of $11,000.

Petitioners' difficulties persisted into 1977. Petitioners separated during the year and Wendy rented a nearby house and worked full-time as a real estate agent. Although Wendy continued to assist in the operation of the farm, petitioner was in charge. To generate cash, petitioners sold in excess of 31 acres of the farm. Petitioners had not intended when they purchased the property to split off part for later resale. Petitioners' horses were exhibited at a number of shows and five horses were sold: Killian's Rebel, Toad's May Lady, King's Miss Rebel, Killian's Tusox and Pesky. Killian's Rebel and Toad's May Lady had proven unsatisfactory for both show purposes and breeding. Three colts, which were later gelded, were born in 1977: Sweet Bar Sandy, Story Fella and an unnamed horse.[5] By the end of 1977, petitioners' owned 10 horses.

On their Schedule C for 1977, petitioners reported receipts of $3,900 from Wenfel Farms and they claimed total deductions of $42,227, for a net loss of $38,327. On their Form 4797 petitioners reported the following receipts from the sale of horses: Killian's Rebel, purchased for $2,500 and fully depreciated, sold for $350; Toad's May Lady, purchased for $1,500 and fully depreciated, sold for $1,000; King's Miss Rebel, one of

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[5] Petitioners' records refer to this horse as a "50% gelding."

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petitioner's foals, sold for $5,000, leaving petitioners a $4,500 gain after payment of a commission; Killian's Tusox, another foal, sold for $2,500; and Pesky, yet another foal, sold for $650, giving petitioners a gain in that amount. On a Schedule D petitioners reported an aggregate gain of $69,702 on the sale of three parcels of the farmland. Petitioners on their Form 1040 did not report any income from the textile business.

From October 1972 to the end of 1977, petitioners never consulted with or procured written advice from a professional with business expertise to seek either an increase in income or a decrease in expenses of Wenfel Farms. Petitioners kept pedigree, show breeding and veterinary records, but did not prepare basic financial records such as profit and loss statements or balance sheets.

In a notice of deficiency to petitioners, respondent disallowed losses claimed by petitioners from their quarter horse operation. Respondent stated that these losses were not from an activity entered into for profit.

OPINION

The only issue presented is whether the operation of Wenfel Farms was an activity not engaged in for profit. Section 183 disallows certain deductions attributable to an activity not

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engaged in for profit.[6] An "activity not engaged in for profit" is defined by section 183(c) as any activity other than one for which deductions are allowable under section 162 (relating to trade or business expenses) or section 212(1) or 212(2) (relating to expenses for the production or collection of income, or for the management, conservation or maintenance of property held for the production of income).

Breeding and raising horses for sale may constitute a trade or business for purposes of section 162. Engdahl v. Commissioner, 72 T.C. 659, 665 (1979). Whether it does or not depends on whether making a profit was the primary purpose of the venture. Engdahl v. Commissioner, supra at 666; Dunn v.

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6 SEC. 183. ACTIVITIES NOT ENGAGED IN FOR PROFIT.

(a) General Rule.--In the case of an activity engaged in by an individual * * *, if such activity is not engaged in for profit, no deduction attributable to such activity shall be allowed under this chapter except as provided in this section.

(b) Deductions Allowable.--In the case of an activity not engaged in for profit to which subsection (a) applies, there shall be allowed--

(1) the deductions which would be allowable under this chapter for the taxable year without regard to whether or not such activity is engaged in for profit, and

(2) a deduction equal to the amount of the deductions which would be allowable under this chapter for the taxable year only if such activity were engaged in for profit, but only to the extent that the gross income derived from such activity for the taxable year exceeds the deductions allowable by reason of paragraph (1).

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Commissioner, 70 T.C. 715, 720 (1978), affd. 615 F.2d 578 (2d Cir. 1980). A taxpayer need not prove that he had a reasonable expectation of profit in order to establish that he engaged in the activity for profit; he must show, however, that he entered into or continued the activity with the actual and honest objective of making a profit. Sec. 1.183-2(a), Income Tax Regs.; Dreicer v. Commissioner, 78 T.C. 642, 645 (1982), affd. without opinion 702 F.2d 1205 (D.C. Cir. 1983); Golanty v. Commissioner, 72 T.C. 411 (1979), affd. without opinion 647 F.2d 170 (9th Cir. 1981). In determining the taxpayer's purpose, greater weight is given to objective facts than to the taxpayer's mere statement of intent. Sec. 1.183-2(a), Income Tax Regs.

All facts and circumstances that bear on the activity are to be taken into account in determining whether it was engaged in for profit. Sec. 1.183-2(b), Income Tax Regs. Included in the regulation are nine factors as among those that should normally be considered: (1) The manner in which the taxpayer carried on the activity; (2) the expertise of the taxpayer or his advisors; (3) the time and effort expended by the taxpayer in carrying on the activity; (4) the expectation that assets used in the activity may appreciate in value; (5) the success of the taxpayer in carrying on other similar or dissimilar activities; (6) the taxpayer's history of income or losses with respect to the activity; (7) the amount of occasional profits, if any, which are earned; (8) the financial status of the taxpayer; and (9) the

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presence of elements of personal pleasure or recreation. No single factor is controlling. Golanty v. Commissioner, supra at 426; Dunn v. Commissioner, supra at 720.

Petitioners argue that they were engaged in the business of breeding, raising and showing horses. Respondent contends that petitioners' quarter horse operation was not a business. We agree with respondent.

In support of their argument that the quarter horse operation was a business, petitioners point to the manner in which the operation was conducted. Petitioners assert that they (1) purchased a suitable facility for the conduct of a business, (2) maintained a full set of books, (3) publicized their operation extensively, and (4) made changes in operating procedures in an effort to increase profitability. These assertions are not fully supported in the record. To the extent they are supported, we have not been persuaded that petitioners intended to make a profit from the operation of Wenfel Farms.

First, while Wenfel Farms may have been generally suitable for use as an operating horse farm, it may not have met the needs of a horse breeder beginning a business venture.[7] Additionally, petitioners purchased more than a basic facility on which horses

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[7] Petitioners sold part of the property in 1977. Wendy gave the following testimony regarding the sale:

> We had realized that we had over -- we had bought more land than we actually needed, and we needed to sell off some of the business property in order to keep our horse operation going. * * *

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could be bred, trained and sold. They acquired a large tract of land within commuting distance of New York City with a fully landscaped four-bedroom house and swimming pool. Petitioners have not established that the Wenfel Farms property was suitable or designed to be other than a recreational horse-breeding facility.

Second, while petitioners maintained certain financial and equine records, there is no indication that they used them to consider and implement cost savings and/or produce profits. Petitioners did not have profit and loss statements or balance sheets prepared for their quarter horse operation.[8] Keeping pedigree, show, breeding and veterinary records, as petitioners did, is as consistent with pursuing a hobby as it is with running a business. See Golanty v. Commissioner, supra at 430.

Third, recreation and personal recognition rather than profit-seeking appear to have motivated petitioners to participate in horse shows and advertise in equine publications. The financial benefit to petitioners from taking part in numerous horse shows was not commensurate with the effort involved nor, we believe, with the personal satisfaction petitioners took from attending these events and having their horses compete. Petitioners' advertising and occasional sale of a horse only

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8 In contrast, monthly trial balances and quarterly profit and loss statements were prepared for petitioner's textile business.

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partially offset their expenses. This is not the same as a consistent effort to exhibit and advertise in order to realize a profit on the overall operation of the horse farm.

Fourth, any possible benefits from changes petitioners claim to have instituted to produce profits were more than offset by their continuing unsound practices. For example, in 1974 petitioners began to breed their mares with a better quality stallion owned by another horse breeder. During the taxable years at issue, however, poor breeders and show animals were retained for extended periods.[9] Although petitioners replaced trainers, they made no significant changes in their efforts to market horses.

Petitioners claim that they consulted with and relied on experts in operating Wenfel Farms, but the evidence fails to support this assertion. At no time during the six highly unprofitable years before us did petitioners turn to an independent outside consultant for advice on the purchase of property, selection of horses, or management of the farm. Instead, petitioners relied on their own admittedly limited experience and on informal discussions with individuals whose objectivity and ability to organize and manage a profit-making horse farm has not been established. While a formal market study is not required under the regulations, a basic investigation of

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[9] For instance, petitioners kept Toad's May Lady for over five years although she was inadequate both as a brood mare and show horse.

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the factors that would affect profit is. See Golanty v. Commissioner, supra at 432; compare Engdahl v. Commissioner, supra at 668.

Petitioners spent considerable time attending to the operation of their horse farm. They argue that their hard work bespeaks an intention to realize a profit. Hard work alone, however, is not enough to establish a profit-seeking motive. See Golanty v. Commissioner, supra at 427; Burger v. Commissioner, T.C. Memo. 1985-523, on appeal (7th Cir., Apr. 4, 1986). Like businesses, recreational pursuits are at times tedious and unpleasant. Petitioners and their family enjoyed activities involving horses, and we believe that they were willing to muck stalls and perform other unappealing tasks as the price for their enjoyment.[10]

Despite operating losses extending over six years, petitioners claim to have made a net profit overall after unrealized appreciation in the value of their land and horses is taken into account. Petitioners' claim rests implicitly on the proposition that operating the horse farm and holding the farmland constituted a single activity for petitioners, rather

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[10] Sec. 1.183-2(b)(3), Income Tax Regs., in part provides that a taxpayer's withdrawal from another occupation to devote most of his energies to an activity may be evidence that the activity is engaged in for profit. For part of 1976 and all of 1977, petitioner, formerly a highly compensated executive in the textile industry, worked full-time on the farm. He did so, however, only after Felbar Fabrics Corp. had failed. The record does not indicate that petitioner declined opportunities in the textile business in order to work on the farm.

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than separate activities, so that appreciation in the value of the horses and of the land are considered together. Petitioners' proposition as presented is highly questionable. See section 1.183-1(d)(1), Income Tax Regs.; Golanty v. Commissioner, 72 T.C. 411, 429-430 (1979); Frazier v. Commissioner, T.C. Memo. 1985-61; Boddy v. Commissioner, T.C. Memo. 1984-156, affd. without published opinion 756 F.2d 884 (11th Cir. 1985). We need not decide, however, whether petitioner's claim is correct. Petitioners' claim of a net profit overall is based on unsubstantiated estimates of the appreciation in value over cost, as of December 31, 1977, of their herd and of their unsold farmland. We do not accept these estimates and on this basis reject petitioners' claim.

Petitioners argue that their operating losses are typical of the start-up phase of a horse-breeding business and, moreover, were due to circumstances beyond their control. They attribute their difficulties to economic recession, inflation, marital discord, ailments suffered by their horses, problems with their trainers and the failure of petitioner's textile business. Difficulties at the outset, anticipated and unanticipated, indeed may cause losses in a profit-oriented operation; it does not follow, however, that an operation that suffers such difficulties is profit-oriented, rather than recreational in nature.

> [T]he presence of losses in the formative years of a business, particularly one involving the breeding of horses, is not inconsistent with an intention to achieve a later profitable level of operation, bearing in mind, however, that the goal must be to realize a

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> profit on the entire operation, which presupposes not only future net earnings but also sufficient net earnings to recoup the losses which have meanwhile been sustained in the intervening years.

Bessenyey v. Commissioner, 45 T.C. 261, 274 (1965), affd. 379 F.2d 252 (2d Cir. 1967), cert. denied 389 U.S. 931 (1967). Petitioner testified that he expected to recover his losses and make a profit five to eight years from the start of his horse breeding operation. He testified in general terms about the prices yearlings and two-year-olds and horses with better breeding commanded, but never stated the mix or number of horses he expected to sell at various points in the operation of Wenfel Farms. It is not for us to surmise how petitioners might have gone about eliminating losses that mounted yearly. Given the vagueness of petitioners' purported plan and their history of losses, we are not persuaded that start-up difficulties or unforeseen circumstances masked a true intention to make a profit.

The possibility of receiving a substantial profit from a highly speculative venture may indicate that the activity is engaged in for profit, even if losses are actually generated. See sec. 1.183-2(b)(7), Income Tax Regs. Petitioners claim that a number of their horses "'just missed' becoming great horses" and that "[t]he production of only one or two such great horses could have changed the entire profit picture of the business." Based on our review of the record, petitioners were never on the threshold of economic success. For instance, while petitioners

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claim to have been offered $20,000 for Fancy Feather, the mare in fact sold for $8,500, $2,500 less than its purchase price. Obviously, petitioners could not have offset their losses through such sales, nor through a breeding program that never produced a foal selling for more than $5,000.

A desire to establish a source of retirement income, according to petitioners, was a major reason for their decision to set up a horse-breeding operation. Petitioners attempt to equate their financial situation with that of the taxpayers in Engdahl v. Commissioner, supra, whom we concluded had founded a horse-breeding business in the hope of producing retirement income. Those taxpayers, however, differed in important respects from petitioners herein. Dr. Engdahl's retirement from his professional practice was imminent at the time he established a horse-breeding operation. Neither he nor his wife rode horses, and the personal pleasure of their children was not a factor in their decision to begin a horse farm. Our consideration of the facts in this case does not lead us to the conclusion that retirement planning played a role in petitioners' acquisition and operation of a horse farm.

What we do believe to be of significance was petitioners' financial ability to pursue an expensive form of recreation. For most of the years at issue, petitioner's income from his textile business was more than adequate to provide funds for this type of

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recreation.[11] For each of those years petitioners were able to offset part of this income by losses from Wenfel Farms; in effect, the Government subsidized part of the tab for petitioners' choice of an avocation and lifestyle.

Although petitioners maintain that they did not derive personal pleasure or recreation from their horse operation, the evidence is to the contrary. Both petitioners were avid riders. They regarded horse shows as a rewarding family activity, and took pride in the performance of their horses at these events.

In summary, we conclude that petitioners' quarter horse operation was not an activity engaged in for profit. Accordingly, the losses claimed by petitioners from Wenfel Farms are allowable only as provided in section 183(b).

To reflect concessions,

Decision will be entered under Rule 155.

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[11] Petitioners' income from this source ended in 1977, but other factors bearing on petitioners' intent did not change significantly.

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UNITED STATES TAX COURT

JIMMY L. AND REDELL DU BOSE, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 17226-85. Filed July 14, 1986.

J. Steven Erie, for the respondent.

MEMORANDUM OPINION

ORIGINAL

KORNER, Judge: By notice of deficiency dated March 15, 1985, respondent determined a deficiency in income tax and additions to tax against petitioners as follows:

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		Additions to Tax		
Year	Deficiency	§6653(a)(1)[1/] Negligence	§6653(a)(2) Negligence	§6661 Substantial Understatement
1982	$15,013.08	$750.65	To be determined	$1,501.30

In his said statutory notice of deficiency, the above deficiency was computed based upon respondent's determinations (a) that claimed business expenses in the form of wages, in the amount of $59,087.47, were not allowable; (b) that petitioners had unreported interest income in the amount of $175; and (c) that petitioners had unreported taxable unemployment compensation in the year in the amount of $620.

At the time their petition herein was filed, petitioners were residents of Atlanta, Georgia. In said petition, after raising a number of frivolous and tendentious tax protestor issues which require no further scholarly discussion or comment,[2/] (see Ginter v. Southern, 611 F.2d 1226, 1229 (8th Cir. 1979); Rowlee v. Commissioner, 80 T.C. 1111, 1114 (1983)), the main thrust of petitioners' petition was that their wages were

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1/ All statutory references are to the Internal Revenue Code of 1954, as in effect in the year in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure, except as otherwise noted.

2/ Included among such frivolous issues raised by petitioners were: whether petitioners were "persons" and "taxpayers" and were required to file income tax returns, and whether petitioners were entitled to a trial by jury in this Court.

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not taxable income. Petitioners also sought to recover their costs of bringing the instant action.3/ Respondent's answer denied all the allegations of the petition.

Respondent thereafter filed a motion for summary judgment herein, joined with a request for the award of damages in favor of the United States under section 6673. Said motion was calendared for hearing at a trial session of the Court on May 12, 1986, at Atlanta, Georgia. When the motion was called for hearing, there was no appearance by petitioners nor by anyone on their behalf. Petitioners had, however, previously filed with the Court a written response to respondent's motion for summary judgment, in affidavit form, and such written statement in lieu of personal appearance was accepted pursuant to Rule 50(c).

With respect to motions for summary judgment, Rule 121 provides in pertinent part:

RULE 121. SUMMARY JUDGMENT

> **(a) General:** Either party may move, with or without supporting affidavits, for a summary adjudication in his favor upon all or any part of the legal issues in controversy. Such motion may be made at any time commencing 30 days after the pleadings are closed but within such time as not to delay the trial.
>
> **(b) Motion and Proceedings Thereon:** The motion shall be filed and served in accordance with the requirements otherwise applicable. See Rules 50 and 54. An opposing written response, with or without supporting affidavits, shall be filed within such period as the Court may direct. A decision shall

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3/ Petitioners raised no issue regarding respondent's determination of additional income from interest or from unemployment compensation, and such issues are therefore deemed to be conceded. Rule 34(b).

thereafter be rendered if the pleadings, answers to interrogatories, depositions, admissions, and any other acceptable materials, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that a decision may be rendered as a matter of law. A partial summary adjudication may be made which does not dispose of all the issues in the case.

* * *

(d) **Form of Affidavits; Further Testimony; Defense Required:** Supporting and opposing affidavits shall be made on personal knowledge, shall set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant is competent to testify to the matters stated therein. Sworn or certified copies of all papers or parts thereof referred to in an affidavit shall be attached thereto or filed therewith. The Court may permit affidavits to be supplemented or opposed by answers to interrogatories, depositions, further affidavits, or other acceptable materials, to the extent that other applicable conditions in these Rules are satisfied for utilizing such procedures. When a motion for summary judgment is made and supported as provided in this Rule, an adverse party may not rest upon the mere allegations or denials of his pleading, but his response, by affidavits or as otherwise provided in this Rule, must set forth specific facts showing that there is a genuine issue for trial. If he does not so respond, a decision, if appropriate, may be entered against him.

An examination of the pleadings, respondent's motion for summary judgment, the materials attached thereto covered by respondent's affidavit, and petitioners' response to respondent's motion establishes the following material facts:

For the year 1982, petitioners, husband and wife, filed a joint income tax return, in which they reported gross income from wages in the amount of $59,087.47. Such wages were composed of $7,930 from Citizens and Southern Georgia Corporation, and

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$26,144.60 from the City of Atlanta paid to petitioner Jimmy L. Du Bose, and $729.88 and $24,282.99 paid to petitioner Redell Du Bose by the General Motors Corporation. By a Schedule C attached to said return, petitioners then purported to show a loss of $59,087.47 from a business enterprise described as "Du Boses Labor SVGS," composed of the two petitioners, who were engaged in "compensation for labor." No income was shown from this activity, but only a cost of wages in the above amount. The effect was to report these wages as gross income, and then to take a "deduction" in an identical amount; with the result that petitioners reported zero net taxable income. No other income was disclosed on the return, and no other deductions were claimed.

Upon audit, respondent disallowed the claimed deduction for "wages," allowed petitioners' six personal exemptions as claimed, and computed the resulting deficiency accordingly. Respondent further determined additions to tax under sections 6653(a)(1) and 6653(a)(2), together with an addition to tax for substantial tax understatement under section 6661.

As the party moving for summary judgment, respondent has the burden of proving that there is no genuine dispute as to any material fact and that a decision may be rendered as a matter of law. Jacklin v. Commissioner, 79 T.C. 340 (1982); Shiosaki v. Commissioner, 61 T.C. 861 (1974). The factual materials presented and the inferences therefrom must be viewed in the

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light most favorable to the party opposing the motion. Elkins v. Commissioner, 81 T.C. 669 (1983); Jacklin v. Commissioner, supra.

The Court concludes that there are no material facts in dispute and that respondent is entitled to prevail as a matter of law. The only issue presented is whether petitioners' wage income is subject to tax. This issue has been decided adversely to petitioners so many times that it can no longer be considered a serious issue. Eisner v. Macomber, 252 U.S. 189 (1920); Commissioner v. Duberstein, 363 U.S. 278 (1960); Commissioner v. Glenshaw Glass Co., 348 U.S. 426 (1955); Rowlee v. Commissioner, supra. Petitioners' clumsy attempt to" zero out" their income in the fashion we have described is nothing more than an inartful way of reasserting the long-discredited protestor position that they had a cost basis in their wages equal to the amount thereof.

Wages are clearly to be included in gross income for income tax purposes, not only under the provisions of the cases we have cited above, but under the clear provisions of section 61(a). We find petitioners' actions clearly negligent within the meaning of section 6653(a)(1), and that the entire deficiency involved herein is due to negligence within the meaning of section 6653(a)(2).

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Since the income tax liability as herein determined is $15,013.08, and since petitioners reported zero income and tax on their 1982 return, we further find that the addition to tax under section 6661 is correctly determined.

Finally, we consider the propriety of awarding damages in this case in favor of the United States. Under section 6673, we may award such damages in favor of the United States whenever proceedings before us have been instituted or maintained by a taxpayer primarily for delay, or where the taxpayer's position in such proceedings is frivolous or groundless. The record herein shows that petitioners' position is entirely frivolous and groundless. The record further shows that petitioners were warned repeatedly that their position was baseless, but they chose to ignore such warnings, preferring instead to carry on a lengthy campaign of skirmishing against respondent, both by correspondence and by personal confrontation. As this Court stated in McCoy v. Commissioner, 76 T.C. 1027, 1029-1030 (1981), affd. 696 F.2d 1234 (9th Cir. 1983):

> It may be appropriate to note further that this Court has been flooded with a large number of so-called tax protestor cases in which thoroughly meritless issues have been raised in, at best, misguided reliance upon lofty principles. Such cases tend to disrupt the orderly conduct of serious litigation in this Court, and the issues raised therein are of the type that have been consistently decided against such protestors and their contentions often characterized as frivolous. The time has arrived when the Court should deal summarily and decisively with such cases without engaging in scholarly discussion of the issues or

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attempting to soothe the feelings of the petitioners by referring to the supposed "sincerity" of their wildly espoused positions.

Damages in favor of the United States under section 6673 in the amount of $5,000 are accordingly awarded.

Petitioners have further asked for the award of costs to them in this litigation. However, petitioners are not entitled to any costs as they are not the prevailing party in this proceeding. Sec. 7430(a). In addition, a request for litigation costs is not to be made in the pleadings. Rule 34(b).

An appropriate order and decision will be entered.

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UNITED STATES TAX COURT

JOSEPH PETER HIRL AND MARGARET ELLEN HIRL, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 3629-85. Filed July 14, 1986.

Joseph Peter Hirl, pro se.

Cynthia J. Mattson, for the respondent.

MEMORANDUM OF FINDINGS OF FACT AND OPINION

WOLFE, Special Trial Judge: This case was heard pursuant to the provisions of section 7456(d) of the Internal Revenue Code.[1]

Respondent determined deficiencies in petitioners' Federal income taxes for 1981 and 1982 in the amounts of $10,925.46 and $8,601.52, respectively.

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[1] All statutory section references are to the Internal Revenue Code of 1954, as amended and as in effect during the years in issue, except as otherwise noted.

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After concessions, the only issue presented for decision is whether petitioners are entitled to an investment tax credit with respect to a house which they purchased and leased back to a developer as a model home for one year.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. The stipulation of facts and attached exhibits are incorporated herein by reference. Petitioners resided in Fairfax Station, Virginia, at the time their petition was filed.

On July 31, 1981 petitioners purchased a new house (hereinafter "the house") from Pulte Home Corporation (hereinafter "Pulte") for $154,190. The house is located in the Franklin Farms development in Fairfax County, Virginia. It was the "Leesburg" model.

On the same day they purchased the house, petitioners leased it back to Pulte for a term of one year. Pulte had the option at the end of one year to lease the house on a month to month basis for a period not to exceed five years. Pursuant to the terms of the lease, Pulte was to use and occupy the house as a model home and/or sales office. In fact, during the term of the lease Pulte used the house as a model for demonstration to prospective customers. The model was furnished to give the appearance of a typical suburban home. It did not house machinery that was part of Pulte's construction process.

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The house was not used by Pulte as a prototype for the construction of other Leesburg houses nor was it an integral part of the manufacturing process for the construction of other Pulte houses. Instead, the house was used as a display for sales purposes. Pulte could have built the other Leesburg houses in the Franklin Farms development without building the model home. Pulte had no need for construction of the house as a prototype prior to building the other Leesburg houses.

Upon terminaton of petitioners' one-year lease of the property to Pulte in July, 1982, Pulte did not renew the lease. Pulte's reason for not renewing was that the Leesburg was a relatively small and inexpensive house, and the market demand in the Franklin Farms development was for larger and more expensive homes. Also Pulte wanted to move its model closer to the entrance to the community. Pulte built only two Leesburg houses at Franklin Farms in addition to petitioners' house and ultimately stopped offering the Leesburg for sale. When Pulte ceased using the house as a model and the lease was terminated, petitioners rented the house as a residential home.

The house was a permanent structure with an anticipated life of 50 years. The house on which petitioners claimed an investment credit was a building, a structure enclosing a space within its walls and covered by a roof.

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On their 1981 return petitioners computed $15,506.01 investment credit with respect to the house. Petitioners claimed a $8,899 investment tax credit in 1981. They carried over the unused portion of the investment tax credit to 1982 and claimed a credit in the amount of $5,090.28 for that period.

OPINION

In 1981, section 38 provided for a credit against tax for investments in certain depreciable property. The amount of the credit was a percentage of the "qualified investment", and the regular percentage was 10 percent. Section 46(a)(2)(A) and (B). For property with a useful life in excess of 7 years, the "qualified investment" was the entire basis of the property. Section 46(c). Petitioners claimed a 10 percent credit on the house with a useful life in excess of 7 years, and the amount of the credit is not in dispute. The resolution of this case depends on whether the house was "section 38 property".

Section 48(a)(1) defines property qualifying for the section 38 investment credit as including:

> (B) other tangible property (not including a building and its structural components) but only if such property--
>
> > (i) is used as an integral part of manufacturing, production, or extraction
> > * * *

Under the terms of the applicable statute certain "other tangible property" qualifies for the investment credit, but only if such property does not constitute a "building." If the structure is a building, as defined in section 48(a)(1)(B), it

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will not be property qualifying for the investment credit. E.g., Consolidated Freightways, Inc. v. Commissioner, 74 T.C. 768 (1980), affd. on this point 708 F.2d 1385 (9th Cir. 1983).

The term "building", for purposes of section 48, is broadly defined in section 1.48-1(e)(1), Income Tax Regs.:

> Buildings and structural components thereof do not qualify as section 38 property. The term "building" generally means any structure or edifice enclosing a space within its walls, and usually covered by a roof, the purpose of which is, for example, to provide shelter or housing, or to provide working, office, parking, display, or sales space.* * *

The house was used as a model home initially and subsequently has been rented for use as a residence. Plainly it satisfies the description of a "building" quoted above from the regulations.[2]

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[2] During the years in issue the applicable statute provided:

> SEC. 38. INVESTMENT IN CERTAIN DEPRECIABLE PROPERTY.
> (a) General Rule.--There shall be allowed, as a credit against the tax imposed by this chapter, the amount determined under subpart B of this part.
>
> (b) REGULATIONS.--The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this section and subpart B.

Based on the authority of section 38(b), respondent promulgated section 1.48-1(e)(1), Income Tax Regs., which states:

> (e) Definition of building and structural components. (1) Buildings and structural components thereof do not qualify as section 38 property. The term "building" generally means any structure or edifice enclosing a space within its walls, and usually covered by a roof, the purpose of which is, for example, to provide shelter or housing, or to provide working, office, parking, display, or sales space. The term includes, for example, structures such as apartment houses, factory and office buildings, warehouses, barns, garages, railways or bus stations, and stores. Such terms include any such structure constructed by, or for, a lessee even if such structure must be removed, or ownership of such structure

(footnote continued)

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The regulations exclude from the definition of a "building" a structure which houses property used as an integral part of an activity (manufacturing, production) "if the use of the structure is so closely related to the use of such property that the structure clearly can be expected to be replaced when the property it initially houses is replaced."

Petitioners argue that the house they purchased from Pulte and leased back to the company as a model home was used as an integral part of the manufacturing process, i.e., the house was used as a standard or prototype in constructing other Pulte houses of that design.

Roger Kamuf, Pulte's vice president of sales and marketing in Northern Virginia during the years in issue, testified convincingly that petitioners' house was not a prototype. Mr. Kamuf stated that it was unnecessary to build petitioners' house in order to build other houses because Pulte had developed plans

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(footnote continued from previous page)
reverts to the lessor, at the termination of the lease. Such term does not include (i) a structure which is essentially an item of machinery or equipment, or (ii) a structure which houses property used as an integral part of an activity specified in section 48(a)(1)(B)(i) if the use of the structure is so closely related to the use of such property that the structure clearly can be expected to be replaced when the property it initially houses is replaced. Factors which indicate that a structure is closely related to the use of the property it houses include the fact that the structure is specifically designed to provide for the stress and other demands of such property and the fact that the structure could not be economically used for other purposes. Thus, the term "building" does not include such structures as oil and gas storage tanks, grain storage bins, silos, fractionating towers, blast furnaces, basic oxygen furnaces, coke ovens, brick kilns, and coal tipples.

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for the house. He further testified that petitioners' house was never an integral part of the process of construction of other houses, but functioned as a sales office and marketing tool.

Section 1.48-1(d)(4), Income Tax Regs., states that property is used as an integral part of a specified activity if it is used directly in the activity and is essential to the completeness of the activity. The evidence in this case establishes that the model home was only a sales aid, was not integral to the construction of homes by Pulte and certainly was not essential to the completeness of the other Pulte homes.

Petitioners' reliance on section 1.48-1(e)(1), Income Tax Regs., also is misplaced because the house was "not so closely related to the use of such property that the structure clearly can be expected to be replaced when the property was replaced." The house was not a "special purpose structure".[3] When Pulte

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Under some circumstances special purpose structures are not buildings for purposes of section 38. E.g., Thirup v. Commissioner, 508 F.2d 915 (9th Cir. 1974) (Greenhouses); Brown-Forman Distillers Corp. v. United States, 499 F.2d 1263 (Ct. Cl. 1974) (Whiskey Maturation Facilities); Brown & Williamson Tobacco Corp. v. United States, 369 F. Supp. 1283 (W.D. Ky. 1973) affd. per curiam 491 F.2d 1258 (6th Cir. 1974) (Tobacco Shed). The facts of the present case simply are not analogous to the circumstances in these cases. In Tamura v. United States, 734 F.2d 470 (1984) the Court of Appeals for the 9th Circuit held that a special purpose onion storage shed was a "building" and noted that the shed easily could have been converted to other uses. The Court summarized its views at pp. 472-473: "No matter how you look at it, inside out, upside down, from the east or west, north or south, the structure, even in common parlance, is a building."

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ceased using the house as a model home in July, 1982, the structure was not replaced. Rather, the petitioners continued renting the house and it was used as a residential home.

The record in this case demonstrates that petitioners' house is a "building" within the meaning of section 48 and is not eligible for the investment credit. Respondent is sustained.

To reflect concessions,

Decision will be entered under Rule 155.

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UNITED STATES TAX COURT

JIMMY D. GUILLORY AND KATHERINE L. GUILLORY, Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 1595-83. Filed July 15, 1986.

Jimmy D. Guillory, pro se.

Michael R. Rizzuto, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

WILBUR, Judge: Respondent determined deficiencies in and additions to petitioners' Federal income taxes as follows:

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Petitioner	Year	Deficiency	Additions to Tax Sec. 6651(a)(1)[1]	Sec. 6653(a)	Sec. 6653(b)
Katherine L. Guillory	1979	$3,239	$48.82	$161.95	—
Jimmy D. Guillory	1979	3,239	—	—	$1,619.50
Katherine L. Guillory	1980	3,535	—	—	1,767.50
Jimmy D. Guillory	1980	3,535	—	—	1,767.50

The issues for decision are:

1. Whether there are deficiencies in taxes due from petitioners, individually, in the amounts determined by respondent for the years 1979 and 1980.

2. Whether petitioner Katherine L. Guillory is liable for the additions to tax pursuant to section 6651(a)(1) for failure to file a timely return and section 6653(a) for negligence or intentional disregard of rules and regulations for the year 1979.

3. Whether petitioner Jimmy D. Guillory is liable for additions to tax pursuant to section 6653(b) for fraud for the years 1979 and 1980, and whether petitioner Katherine L. Guillory is liable for such an addition to tax for the year 1980. Alternatively, if it is decided that petitioners are not liable for such additions to tax under section 6653(b), whether they are liable for the additions to tax pursuant to section 6651(a)(1) and section 6653(a) for such years.

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[1] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954, as amended and in effect during the years in issue.

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FINDINGS OF FACT

By Court order dated January 16, 1984, respondent's proposed stipulation of facts and attached exhibits were deemed stipulated pursuant to Rule 91(f),[2] except for the final clauses of paragraphs 7 and 10 of the stipulation. The stipulation and attached exhibits are incorporated herein by this reference.

Petitioners Jimmy D. Guillory and Katherine L. Guillory, husband and wife, resided in Louisiana at the time the petition was filed in this case. During the years in issue, petitioner Jimmy D. Guillory (hereinafter Jimmy) was employed as a machinist by Cities Service Company (Cities Service) in Lake Charles, Louisiana. He was a graduate of both high school and Spencer Business College. Petitioner Katherine L. Guillory (hereinafter Katherine) was employed as an accounting clerk by Gulf Oil Corporation (Gulf Oil) in Lake Charles during the years in issue. She was a high school graduate and had an associate degree from McNeese State.

The Forms W-2 issued by Cities Service to Jimmy indicate that he received wages in 1979 and 1980 in the amounts of $21,265.38 and $19,857.23, respectively. The Forms W-2 issued by Gulf Oil to Katherine indicate that she received wages in 1979 and 1980 in the amounts of $11,362.45 and $14,434.26, respectively. Petitioners' joint 1978 individual income tax

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2 Unless otherwise indicated, all rule references are to the Tax Court Rules of Practice and Procedure.

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return (Form 1040A) reported total wages in the amount of $25,351.69 and a tax liability in the amount of $4,416. The 1978 Form 1040A was signed by both petitioners.

On or about April 15, 1980, petitioners submitted a Form 1040A for 1979 to the Internal Revenue Service Center, Austin, Texas, on which they refused to disclose their income or tax liability, claiming a Fifth Amendment privilege. Attached to the form were various tax protester materials. The form was signed by both petitioners. Petitioners were advised by a letter dated June 23, 1980 from the Internal Revenue Service that this Form 1040A did not qualify as a Federal income tax return. On or about April 15, 1981, petitioners filed a Form 1040A for 1980 with the Internal Revenue Service on which they again refused to disclose their income or tax liability, claiming a Fifth Amendment privilege. Attached to the form were identical tax protester materials. The form was signed by both petitioners. Petitioners were advised by a letter dated June 17, 1981 from the Internal Revenue Service that this Form 1040A did not qualify as a Federal income tax return. Each of the letters from the Internal Revenue Service included an explanation of the requirements of a Federal income tax return. On or about April 15, 1982, Jimmy individually submitted for filing a Form 1040A for 1981 on which he refused to disclose his income or tax liability, again claiming a Fifth Amendment privilege.

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Petitioners knew at the time they submitted for filing their 1979 and 1980 Forms 1040A that they owed Federal income taxes for the 1979 and 1980 taxable years.

Jimmy submitted Forms W-4 (Employee's Withholding Allowance Certificates) to his employer claiming exemption from Federal income tax withholding on November 30, 1979 and January 9, 1980. On each such occasion, he met with Mr. L. J. Armand, payroll supervisor for Cities Service, and Armand explained to Jimmy the qualifications required in order to claim exemption from Federal income tax withholding. Armand explained to Jimmy that if he submitted a Form W-4 falsely claiming to be exempt he could go to jail. The following wording appeared near the bottom of the Forms W-4:

> Under the penalties of perjury, * * * I certify that I incurred no liability for Federal income tax for last year and I anticipate that I will incur no liability for Federal income tax for this year.

After Armand explained the requirements for claiming exemption, Armand had Jimmy sign before him and resubmit the Forms W-4. Jimmy signed and resubmitted the forms even though he knew at such times that he had incurred a Federal tax liability for each of the previous years. Jimmy submitted to his employer additional Forms W-4 claiming exemption from Federal income tax withholding on April 7, 1981 and February 18, 1982.

Katherine submitted a Form W-4 to Gulf Oil claiming exemption from Federal income tax withholding on February 5, 1980. Shortly thereafter she met with her immediate supervisor,

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Mr. William J. Crawford, who counseled her on the execution of the Form W-4 and attempted to convince her to withdraw her claimed exemption from withholding. Katherine, however, refused to change the Form W-4, even though she knew at the time she submitted the Form W-4 that she had incurred a Federal tax liability for 1979.

On or about November 29, 1982, petitioners jointly submitted a Form 1040X (Amended U.S. Individual Income Tax Return) to the Internal Revenue Service for the taxable year 1979 stating thereon that both their corrected income and tax liability were zero and claiming a refund of the full amount of tax withheld from their wages during 1979. A letter attached to the Form 1040X stated that it was submitted, "[i]n order to halt the aggressive action taken against us by the Internal Revenue Service, * * * [t]rusting that this will correct any questions and bring to a stop all of the threats and intimidations." The letter also stated that this aggressive action had resulted from the exercise of their Fifth Amendment rights. Jimmy also submitted Forms 1040X to the Internal Revenue Service for the taxable years 1980 and 1981 stating thereon that both his corrected income and tax liability for each of the years were zero and claiming refunds of the full amount of tax withheld from his wages during 1980 and 1981.

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Petitioners also filed joint State income tax returns for the years 1979 and 1980 with the State of Louisiana in which they refused to disclose any of their income or tax liability, claiming a Fifth Amendment privilege. Jimmy submitted Forms L-4E (State of Louisiana Exemption From Withholding) to his employer on May 31, 1980 and April 7, 1981. Katherine submitted a Form L-4E to her employer on February 5, 1980.

During 1981, petitioners were under investigation by a Lake Charles, Louisiana, revenue agent of the Internal Revenue Service for the taxable years 1979 and 1980. Jimmy failed to appear for scheduled appointments with the revenue agent. The revenue agent referred the case to the Criminal Investigation Division, Internal Revenue Service, where it was assigned to Special Agent Joseph Caccioppi (hereinafter Caccioppi). In July 1981, Caccioppi began investigating petitioners for the taxable years 1979 and 1980. Caccioppi had an initial interview with Jimmy on August 17, 1981, during which Caccioppi identified himself to Jimmy, informed Jimmy that he was under criminal investigation, and advised him as to his rights. On August 18, 1981, Jimmy telephoned Caccioppi and scheduled an appointment for August 20, 1981. Jimmy did not appear for this appointment, but rather, arrived at Caccioppi's office one week later on August 27, 1981. During this meeting, Jimmy asked about the extent of his tax liability, even though the subject had not been raised by Caccioppi prior to petitioner's inquiry.

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In September 1981, Jimmy sent four letters to Cities Service in response to an Internal Revenue Service summons served upon or expected to be served upon Cities Service. One of these letters instructed Cities Service not to disclose any records, forms or paperwork concerning him to the Internal Revenue Service without his permission or a court order. Another of the letters stated that if any records concerning himself were turned over to the Internal Revenue Service in response to the summons, he would seek legal redress against Cities Service for violating his privacy rights. The remaining two letters instructed Cities Service not to honor a request by the Internal Revenue Service to change Jimmy's exempt withholding status and threatened a lawsuit if Cities Service made such a change.

OPINION

1. Deficiencies for 1979 and 1980

The first issue for decision is whether there are deficiencies in taxes due from petitioners, individually, in the amounts determined by respondent for the years 1979 and 1980.

Petitioners have not disputed that they received wages in the amounts determined by respondent. Rather, they argue that wages are an even exchange for labor, and therefore are not taxable. This argument has repeatedly been held to be without merit. E.g., Rowlee v. Commissioner, 80 T.C. 1111, 1120 (1983); Reiff v. Commissioner, 77 T.C. 1169, 1173 (1981); Reading v.

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Commissioner, 70 T.C. 730, 733 (1978), affd. per curiam 614 F.2d 159 (8th Cir. 1980); see also Eisner v. Macomber, 252 U.S. 189 (1920).

Respondent's determination of the deficiencies is presumptively correct. Rule 142(a); Welch v. Helvering, 290 U.S. 111, 115 (1933). Petitioners have offered no evidence with which to overcome this presumption. Accordingly, we hold that petitioners are liable for the deficiencies determined by respondent for the years in issue.

2. Katherine L. Guillory--Additions to Tax for 1979

We next consider whether Katherine is liable for the additions to tax pursuant to section 6651(a)(1) and section 6653(a) for the year 1979.

Section 6651(a) imposes an addition to tax for failure to timely file a return unless the taxpayer shows that such failure was due to reasonable cause and not willful neglect. Courts have consistently held that a document which does not contain sufficient information for respondent to compute and assess a tax liability is not a valid return. Commissioner v. Lane-Wells Co., 321 U.S. 219 (1944); Steinbrecher v. Commissioner, 712 F.2d 195 (5th Cir. 1983); Cupp v. Commissioner, 65 T.C. 68, 79 (1975), affd. without opinion 559 F.2d 1207 (3d Cir. 1977). This Court has held that a return within the meaning of the statute must "state specifically the amounts of gross income and the deductions and credits claimed." Conforte v. Commissioner, 74

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T.C. 1160, 1195 (1980), affd. in part and revd. and remanded in part 692 F.2d 587 (9th Cir. 1982). The Form 1040A submitted by petitioners for the year 1979 clearly did not reflect an endeavor to satisfy the law and did not contain sufficient information to constitute a valid return. We therefore hold that petitioners did not file a timely return for the 1979 taxable year.

The burden is on Katherine to prove that her failure to file was due to reasonable cause and not willful neglect. Rule 142(a). The Form 1040A submitted for 1979 claimed a Fifth Amendment privilege. The privilege against self-incrimination may be asserted with respect to an Internal Revenue Service form only if the taxpayer asserting the privilege shows a "relationship between the information required on the * * * form and a real and appreciable danger of criminal prosecution at the time he was required to complete that form." Rowlee v. Commissioner, supra at 1122-1123; see also Hoffman v. United States, 341 U.S. 479 (1951). The only evidence introduced indicating a fear of criminal prosecution related to the criminal investigation conducted by Mr. Caccioppi. This investigation was not commenced, however, for over two years after petitioners submitted the Form 1040X for 1979. Katherine has not shown that her failure to file for the year 1979 was due to reasonable cause and not willful neglect.

Section 6653(a) imposes an addition to tax if any part of an underpayment is due to negligence or intentional disregard of

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rules and regulations.[3] The burden of proof is on Katherine to establish a lack of negligence or intentional disregard of rules and regulations. Bixby v. Commissioner, 58 T.C. 757, 791 (1972). The return filed by her for 1978 and the protester return submitted for 1979 demonstrate that she was aware of her duty to file returns and she has not alleged that she was unaware of such duty. The record is devoid of any evidence which would suggest that her failure to file a return for 1979 was due to other than negligence or intentional disregard of rules and regulations.

Accordingly, we hold that Katherine is liable for the additions to tax pursuant to section 6651(a)(1) and section 6653(a) for the year 1979.

3. Section 6653(b) Additions to Tax for 1979 and 1980

The final issue for decision is whether Jimmy is liable for additions to tax pursuant to section 6653(b) for fraud for the years 1979 and 1980, and whether Katherine is liable for such an addition to tax for the year 1980.

Jimmy failed to file adequate returns in 1979 and 1980, filed Forms W-4 claiming exemption from Federal income tax withholding in 1979 and 1980, filed Forms 1040X falsely claiming that his income and tax liability were zero and claiming a refund of all income tax withheld during 1979 and 1980, and attempted to

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3 Sec. 6653(c)(1) defines "underpayment" for purposes of sec. 6653 as a "deficiency" as defined in sec. 6211, except that the tax shown on a return referred to in sec. 6211(a)(1)(A) shall be taken into account only if the return was timely filed.

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prevent respondent from obtaining information relating to petitioners' tax liability. Katherine failed to file adequate returns in 1979 and 1980, filed a Form W-4 falsely claiming exemption from Federal income tax withholding in 1980, and filed a Form 1040X falsely claiming that her income and tax liability were zero and claiming a refund of all income tax withheld during 1979. Respondent contends that these actions constitute fraud, and that petitioners are liable for the additions to tax under section 6653(b). We agree.

Section 6653(b) imposes an addition to tax if any part of an underpayment of tax is due to fraud. Fraud may be proved by circumstantial evidence because direct proof of the taxpayer's intent is rarely available. The taxpayer's entire course of conduct may establish the requisite fraudulent intent. Stone v. Commissioner, 56 T.C. 213, 223-224 (1971); Otsuki v. Commissioner, 53 T.C. 96, 105-106 (1969). Respondent bears the burden of proving fraud by clear and convincing evidence. Section 7454(a); Rule 142(b); Stratton v. Commissioner, 54 T.C. 255, 284 (1970), modified as to another issue 54 T.C. 1351 (1970). Fraud has been described as an "intentional wrongdoing * * * motivated by a specific purpose to evade a tax known or believed to be owing." Stoltzfus v. United States, 398 F.2d 1002, 1004 (3d Cir. 1968); Webb v. Commissioner, 394 F.2d 366 (5th Cir. 1968). The elements to be shown are (1) an

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underpayment of tax,[4] and (2) that some part of this underpayment was due to fraud. Plunkett v. Commissioner, 465 F.2d 299, 303 (7th Cir. 1972). We find that the Forms W-2 issued by Cities Service and Gulf Oil and petitioners' failures to report those amounts constitute clear and convincing evidence of the existence of underpayments during the years in issue.

Petitioners knowingly submitted false information when they filed Forms W-4 claiming exemption from Federal withholding. Petitioners had paid taxes in the past, and they knew that they were required to pay Federal income tax. The requirements for filing Forms W-4 claiming exemption had been explained to both petitioners and by stating that they anticipated no tax liability in the years they filed the Forms W-4 claiming exemption, petitioners knowingly gave false information to the Federal Government. The filing of false certificates claiming that the taxpayer is exempt from withholding is evidence of fraud. Hebrank v. Commissioner, 81 T.C. 640, 642 (1983); Habersham-Bey v. Commissioner, 78 T.C. 304, 313-314 (1982).

The Forms 1040A filed by petitioners for 1979 and 1980 contained inadequate information to constitute income tax returns within the meaning of the Internal Revenue Code. Steinbrecher v. Commissioner, 712 F.2d 195, 198 (5th Cir. 1983); United States v. Smith, 618 F.2d 280 (5th Cir. 1980). Petitioners were notified

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4 See note 3, supra.

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repeatedly by respondent that the forms they submitted did not constitute adequate returns. Failure to file tax returns, without more, is not conclusive proof of fraud. Stoltzfus v. United States, supra. However, failure to file is a factor worthy of consideration, particularly when coupled with the submission of false Forms W-4. Habersham-Bey v. Commissioner, supra at 313. This has been held to be true in cases where the failure to file was a result of the submission of inadequate returns. Hebrank v. Commissioner, supra.[5] The submission of false Forms W-4 and protester-type Forms 1040 supports the inference that petitioners' failure to file was motivated by a fraudulent intention to evade taxes rather than a genuine fear of self-incrimination. See Rechtzigel v. Commissioner, 79 T.C. 132, 138-139 (1982), affd. per curiam 703 F.2d 1063 (8th Cir. 1983).[6]

Petitioners also indicated their fraudulent intent by submitting Forms 1040X falsely claiming that their income and tax liability were zero and seeking refunds of the tax withheld. Regardless of their views about our system of Federal income taxation, petitioners did receive wages during the years in issue and they knew of their duty to report the wages as income.

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5 See also Rogers v. Commissioner, T.C. Memo. 1984-116; Watkins v. Commissioner, T.C. Memo. 1983-603; Hebrank v. Commissioner, T.C. Memo. 1982-496; Fuhrmann v. Commissioner, T.C. Memo. 1982-255.

6 See also Rogers v. Commissioner, supra.

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Petitioners are badly mistaken if they believe that a proper method of expressing their dissatisfaction with our system of taxation is to pursue a course of tax evasion.

Respondent has shown by clear and convincing evidence that petitioners purposefully attempted to evade a tax known to be owing. Accordingly, we hold that petitioner Jimmy D. Guillory is liable for additions to tax pursuant to section 6653(b) for the years 1979 and 1980, and that petitioner Katherine L. Guillory is liable for such an addition to tax for the year 1980.

Decision will be entered for the respondent.

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UNITED STATES TAX COURT

WILLIAM M. LAXSON AND ROSEMARY M. LAXSON, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 1884-85. Filed July 15, 1986.

William M. Laxson, pro se.

Mark I. Siegel, for the respondent.

MEMORANDUM OPINION

PATE, Special Trial Judge: This case[1] was heard pursuant to the provisions of section 7456(d)(3)[2] and Rules 180, 181 and 182.[3]

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1 This case was originally filed as a small tax case pursuant to sec. 7463. By order dated January 14, 1986, the Court granted petitioners' motion to remove this case from the small tax case category.

2 Unless otherwise specified, all section references are to the Internal Revenue Code of 1954, as amended and in effect during the year in issue.

3 All rule references are to the Tax Court Rules of Practice and Procedure.

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Respondent determined a $730 deficiency in petitioners' 1981 Federal income tax. The sole issue for our decision is whether petitioners' cooling system qualifies as renewable energy source property entitling them to a residential energy credit for 1981.

William M. Laxson (hereinafter "William") and Rosemary M. Laxson are husband and wife and filed a joint return for 1981. They resided in Xenia, Ohio, at the time their petition was filed. Some of the facts in this case have been stipulated and are so found.

In 1981, petitioners installed a deep well water circulation system (hereinafter "system") to cool their residence. The system pumps well water of approximately 55 degrees Fahrenheit through a series of copper pipes and by circulating air over these pipes the house is cooled using a reduced amount of electricity. The system's cost was $1,825. Petitioners claimed a geothermal energy credit of $730 on their 1981 income tax return. Respondent disallowed the claimed credit in its entirety.

An individual taxpayer is allowed a credit against his tax equal to forty percent of his cost of qualified renewable energy source expenditures made with respect to "renewable energy source property." Sec. 44C(a)(2), (b)(2), and (c)(2)(A).[4] Renewable energy source property specifically includes property which

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Code sec. 44C has been redesignated as sec. 23 by sec. 471(c), Deficit Reduction Act of 1984, 98 Stat. 826. This change is effective for taxable years beginning after December 31, 1983. Sec. 475(a), Deficit Reduction Act of 1984, 98 Stat. 847.

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transmits or uses energy derived from geothermal deposits to heat, cool or provide hot water or electricity for use in the dwelling. Sec. 44C(c)(5).[5]

Section 1.44C-2(h), Income Tax Regs., defines "geothermal energy property" to include:

> equipment * * * necessary to transmit or use energy from a geothermal deposit to heat or cool a dwelling or provide hot water for use within the dwelling. * * * A geothermal deposit is a geothermal reservoir consisting of natural heat which is from an underground source and is stored in rocks or in an aqueous liquid or vapor (whether or not under pressure), having a temperature exceeding 50 degrees Celsius as measured at the wellhead * * *. [Emphasis supplied.]

Petitioners concede that their system uses ground water that is cooler than the temperature specified in section 1.44C-2(h), Income Tax Regs. However, they contend that an energy source emitting heat at 50 degrees Celsius cannot be used to cool a house and that, therefore, the regulation is unreasonable. They assert that the temperature of a geothermal deposit would have to be either far less than 50 degrees Celsius (122 degrees Fahrenheit) to directly cool the air circulating in a house (hereinafter "convectional cooling") or far more than 50 degrees

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5 In addition, the property's original use must commence with the taxpayer, the property must reasonably be expected to remain in operation for five years, and the property must meet quality and performance standards prescribed by the Secretary. Sec. 44C(c)(5). Nevertheless, we confine this opinion to the only issue raised by the parties, namely, what items come within the definition of "geothermal energy property."

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Celsius to operate an "absorption refrigeration cycle" system.[6] Petitioners argue that since the regulation prescribes a temperature that is too hot for convectional cooling and too cool for the absorption refrigeration cycle, that, from a technical aspect, it is unreasonable as it pertains to cooling systems.

Petitioners have misconstrued section 1.44C-2(h), Income Tax Regs. That regulation only requires that a geothermal energy source have a temperature "exceeding 50 degrees Celsius." Sec. 1.44C-2(h), Income Tax Regs.[7] The regulation does not set a maximum temperature. Therefore, petitioners' argument that a geothermal deposit would require a temperature far exceeding 50 degrees Celsius to cool a dwelling proves the very reasonableness of the regulation they dispute.

Moreover, this regulation was promulgated pursuant to a specific statutory authority. Sec. 44C(c)(6)(A)(i). Since such regulations are legislative in nature, they are entitled to great weight and must be sustained unless unreasonable and clearly inconsistent with the statute they implement. Olson v. Commissioner, 81 T.C. 318, 323 (1983); Wing v. Commissioner, 81

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At trial, William, an engineer, described how the heat produced from a geothermal energy source could be harnessed to operate an absorption refrigeration cycle system. He explained that heat in excess of 98 degrees Celsius would be necessary for such operation.

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This is to insure that only property transmitting or using geothermal as opposed to surface sources of energy qualifies as geothermal property. Bayless v. Commissioner, T.C. Memo. 1986-113; Reddy v. Commissioner, T.C. Memo 1984-395, affd. per order (4th Cir., August 29, 1985).

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T.C. 17, 28 (1983). This Court has previously examined this regulation and found it to be reasonable. Peach v. Commissioner, 84 T.C. 1312, 1317 (1985), on appeal (4th Cir., Sept. 13, 1985); Reddy v. Commissioner, T.C. Memo. 1984-395, affd. per order (4th Cir., August 29, 1985).[8]

In addition, petitioners maintain that the regulations are not applicable because they are retroactive. However, we find that the regulation was promulgated prior to the year in issue. See T.D. 7717, 1980-2 C.B. 7, 14. Moreover, we have held that the retroactive application of this regulation was not an abuse of the Commissioner's authority. Peach v. Commissioner, supra at 1318; see sec. 7805(b).

Accordingly, we find that petitioners are not entitled to a residential energy credit for the year 1981.

Decision will be entered

for the respondent.

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Indeed, we have found that this Regulation reflects the intent of Congress. Hickey v. Commissioner, T.C. Memo. 1986-186; Rabenold v. Commissioner, T.C. Memo. 1985-309, affd. without published opinion 786 F.2d 1177 (11th Cir. 1986).

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UNITED STATES TAX COURT

ALLAN B. SCHACHTER AND RUTH G. SCHACHTER, ET AL.,[1] Petitioners
v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket Nos. 5422-83, 5485-83, 5648-83. Filed July 15, 1986.

David A. Brownlee, for the petitioners.

Edward J. Laubach, for the respondent.

MEMORANDUM FINDINGS OF FACTS AND OPINION

SHIELDS, Judge: Respondent determined deficiencies in income tax due from petitioners for 1980 as follows:

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[1] Cases of the following petitioners are consolidated herewith for trial, briefing and opinion: Barry B. Sokolow and Arlene Z. Sokolow, docket No. 5485-83; and Frank H. Kush and Margaret B. Kush, docket No. 5648-83.

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Petitioners	Docket No.	Deficiency
Allan B. Schachter and Ruth B. Schachter	5422-83	$30,135.00
Barry B. Sokolow and Arlene Z. Sokolow	5485-83	11,784.00
Frank H. Kush and Margaret B. Kush	5648-83	29,190.00

The only issue for our decision is what is the fair market value of certain opals donated by petitioners to the Carnegie Museum of Natural History.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. The stipulation and exhibits attached thereto are incorporated herein by reference.

At the time their petitions were filed, all petitioners resided in the State of Pennsylvania. Each pair of petitioners filed a joint Federal income tax return for the taxable year 1980 with the Internal Revenue Service Center at Philadelphia.

During 1979 and 1980, Sokolow[2] was a certified public accountant and a practicing lawyer. In his practice he rendered tax advice, did tax planning and prepared income tax returns. His clients included the Schachters and the Kushes.

Kenneth Helfand, a friend of Sokolow, was the president during 1979 and 1980 of Australian Mining and Exploration Company which purchased, carved, and resold opals. From discussions with Helfand, Sokolow learned of possible tax advantages which an

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[2] All references to Sokolow, Schachter or Kush in the singular are to male petitioners.

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individual could obtain by purchasing carved opals from Australian Mining and after the appropriate statutory period donating them to a charitable organization at a value in excess of their original purchase price. In 1979 Sokolow told the Schachters and the Kushes that he was going to purchase some opals and subsequently make "the necessary" donations. Upon his advice they decided to do the same.

Through Helfand, Sokolow arranged for the purchase of all of the opals and neither Schachter nor Kush participated in the negotiations. However, all of petitioners, including Sokolow, relied upon Helfand to select the particular opals they purchased because none of them had ever dealt in opals. Petitioners merely advised Australian Mining through Helfand of the amount of money they wished to spend and made no attempt to specify the number, size, color, or shape of the opals they were buying.

On December 19, 1979, Sokolow purchased four opal carvings from Australian Mining for $4,977. The purchase was represented by two invoices which Sokolow received from Australian Mining. The first invoice reflected the purchase of a rough opal weighing 623.4 grams for $3,777. The second invoice reflected labor charges of $1,200 to carve the opal into four separate carvings.

On December 21, 1979, Schachter purchased two opal carvings and a free-form[3] specimen from Australian Mining for $10,059. His purchase was represented by four invoices which Schachter

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[3] A free-form opal specimen is an opal that has not been carved and has no visible design in its execution. It is typically polished and has one flat surface so that it can be placed on display in an upright position.

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received from Australian Mining at the time of the purchase. One invoice reflected the purchase of a rough black opal weighing 69.7 grams for $7,159. A second invoice reflected the purchase of a rough opal weighing 93.4 grams for $1,900. The other two invoices reflected labor costs totaling $1,000 for carving and finishing the opals into the two carvings and the free-form specimen.

On December 21, 1979, Kush also purchased a finished free-form opal specimen from Australian Mining for $9,420. His purchase was represented by two invoices which Kush received from Australian Mining. One invoice covered the purchase of a rough semi-black opal weighing 210.5 grams for $9,020 and the other reflected labor charges of $400 to finish the opal into the free-form specimen.

Australian Mining had the purchases appraised by David Wilber on December 26, 1979 which was prior to their delivery to petitioners. The record does not reveal the amount for which he appraised Schachter's carvings and specimen, but he appraised Sokolow's carvings at $20,703 and Kush's specimen at $49,770. On December 30, 1979, Ben Gordon appraised all of the purchases for Australian Mining. He assigned total values to the purchases made by Schachter, Sokolow and Kush of $53,406.50, $28,310.45, and $47,103.75, respectively. Gordon was chosen by Helfand because he was willing to assign values within ranges suggested by Helfand.

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Petitioners did not see their opal carvings and specimens until their receipt in January of 1980. At or about the time of their receipt, petitioners also received letters from Delbert Oswald of the Carnegie Museum of Natural History soliciting the contribution of the opals to the museum. The letters had been written at the request of Helfand who was a personal friend of Oswald. Each letter mentioned the tax benefits to be derived from the solicited contribution and that the museum was qualified under section 170 and section 501 to receive tax deductible donations.

On December 23, 1980, Wilber, at the request of petitioners, updated his appraisals. At that time he assigned a fair market value to the Schachters' two carvings and specimen of $15,603, the Sokolows' carvings of $24,843.60 and the Kushes' specimen of $57,768.75. On December 24, 1980, Antonio Bonanno appraised the Schachters' free-form specimen at $43,061.

On December 23, 1980, the Schachters, Sokolows, and Kushes donated their opals to the Carnegie Museum. The museum placed them on its books at $60,047, $24,844, and $49,770, respectively, but did not have them appraised. On January 19, 1981, Gordon, without reappraising the opals, updated his estimate of their fair market values to $58,747.15, $19,729.00, and $51,814.13, respectively.

On their 1980 income tax returns, the Schachters, Sokolows and Kushes claimed deductions for the contributions of the opals to the Carnegie Museum in the respective amounts of $58,664, $24,844, and $57,769. Insofar as applicable here respondent

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disallowed the deductions for lack of substantiation by petitioners as to the value of the opals on the date of their contribution.[4]

In February 1984, respondent had the opals appraised by Cosmo Altobelli and Elly Rosen. Altobelli valued the opals of the Schachters, Sokolows, and Kushes at $2,775, $4,175, and $900, respectively. Rosen's appraisals were $1,114.87, $1,748.47, and $480.03, respectively.

OPINION

Where, as here, a contribution is made in property other than money, the amount of the contribution is the fair market value of the property as of the date contributed, reduced when applicable as provided in section 170(e)(1).[5] The generally accepted definition of fair market value is set forth in respondent's regulations as "the price at which the property

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[4] In the statutory notice respondent also stated that petitioners had failed to establish the donations were completed during 1980, but prior to trial respondent conceded that petitioners made completed gifts to the Carnegie Museum during 1980.

[5] Section 170(e)(1) reads in pertinent part as follows:

> (1) General Rule.--The amount of any charitable contribution of property otherwise taken into account under this section shall be reduced by the sum of--
>
> > (A) the amount of gain which would not have been long-term capital gain if the property contributed had been sold by the taxpayer at its fair market value (determined at the time of such contribution), * * *.

However, section 170(e) is not applicable here because on the dates of the contributions petitioners had owned the opals for more than one year and would have qualified to treat any gains from their sale as long term capital gains under section 1222.

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would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts." Section 1.170A-1(c)(2), Income Tax Regs. Fair market value as of any given date is a question of fact to be resolved by considering all relevant evidence in the record.[6] Kaplan v. Commissioner, 43 T.C. 663, 665 (1965).

Respondent in his statutory notices of deficiency originally asserted that the value of the opals in each case on the date of their contribution did not exceed their purchase price. However, in his answer respondent asserted that the fair market value of the opals was in fact less than their original purchase price. Consequently, respondent has the burden of proof that the values

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[6] The fair market value of art can be the object of considerable disagreement among appraisers. See Neely v. Commissioner, 85 T.C. 934 (1985); Chiu v. Commissioner, 84 T.C. 722 (1985); Anselmo v. Commissioner, 80 T.C. 872 (1983), affd. 757 F.2d 1208 (11th Cir. 1985).

The Tax Reform Act of 1984 amended section 6659 so as to provide increased additions to tax for valuation overstatements, reporting requirements for charitable donees which receive property and dispose of it within two years and detailed appraisal requirements. When applicable, the statute requires the donor to obtain a "qualified appraisal" which, pursuant to the Temporary Regulations, means the appraisal must have been conducted by a qualified appraiser not earlier than 60 days prior to the contribution. Section 6659(f); section 1.170A-13T(c)(3)(i)(A), Temporary Income Tax Regs., 48 Fed. Reg. 50659 (Dec. 31, 1984). A qualified appraiser is an appraiser who was not a party to the transaction in which the donor obtained the property nor related to any person whose relationship to the donor would cause a reasonable person to question their independence. See section 1.170A-13T(c)(5), Temporary Income Tax Regs., 48 Fed. Reg. 50659 (Dec. 31, 1984).

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were less than the purchase prices and petitioners have the burden of proof that the values were greater than the purchase prices. Rule 142(a).

In support of respondent's contentions the record contains appraisal reports by two experts, Cosmo Altobelli and Elly Rosen. Altobelli has been an appraiser of gems since 1948 and is a graduate of the Gemological Institute of America. He is a certified gemologist appraiser, an author of a book on guidelines for jewelry appraisal and a member of the Appraisal and Ethics Committee of the American Gem Trade Association. He is obviously a qualified gem appraiser, but he does not specialize in opals. Consequently, he felt it was necessary to have his appraisals reviewed and confirmed by opal specialists. The specialists, however, did not appear as witnesses and their testimony and qualifications are not before us. Therefore, we are unable to attribute any weight to conclusions of such specialists.

Rosen, respondent's other expert, is a gemological consultant and a graduate of the Gemological Institute of America, having completed a two-year course of instruction in diamonds, colored stones and gem identification. He has taught valuation theory and the appraisal of gemstones at the university level and has performed consulting work and tested gemological instruments for trade magazines in the industry. He is a senior member of the American Society of Appraisers. However, at the date of his appraisal in this case, he had been an appraiser for only two years.

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When examined by Altobelli and Rosen in February of 1984 the free-form opal of the Kushes was crazed.[7] The crazing had occurred sometime after Gordon's examination and appraisal in December of 1979. Rosen testified that the opal would have appraised for twice the $480 value he ascribed to it had it not been crazed. Altobelli did not indicate how much the crazing affected the value of $900 which he placed on the opal.

Rosen also testified that in his opinion the Schachters' free-form specimen had been chemically treated in an attempt to pass it off as a more expensive opal. However, the other appraisers including Altobelli, testified to the contrary and we are satisfied that Rosen's conclusion in this regard was erroneous.

In support of petitioners' claims the record contains five appraisals of all of the opals and a separate appraisal of the free-form specimen of the Kushes. Two complete sets of appraisals were prepared by Gordon and Wilber and one set by Oswald. The separate appraisal of Schachter's opal was made by Bonanno.

Gordon appraised the opals for Australian Mining. He is a member of the American Society of Appraisers and had been a gem appraiser for thirteen years at the time he first examined the opals in this case. As set forth in our findings, the opals of the Kushes and the Schachters were first appraised by Gordon after their purchase, but prior to their delivery. In the case

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[7] Crazing is cracking that takes place in an opal and is caused by dehydration or abuse. Crazing causes the value of the opal to decrease.

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of the Sokolows, he first appraised the opals prior to their purchase and delivery. Before the appraisals were made, Gordon was informed by Helfand that the appraisals were being obtained for the purpose of supporting the value of future donations to museums. Furthermore, in each case he was instructed by Helfand that he was not to furnish an appraisal unless he could appraise the opals for the amount suggested by Helfand. With these instructions and under the circumstances, we can only conclude that Gordon's first appraisal was conducted with a serious lack of objectivity and independence and cannot be taken at face value. Moreover, since Gordon's second appraisal amounted to nothing more than a reassignment of value to an earlier unreliable appraisal it follows that it cannot be given much weight.

In March 1984, Oswald appraised the opals donated by the Schachters, Sokolows, and Kushes at $57,378, $26,201, and $49,784, respectively. Oswald's experience in the field dates back to 1942 when he received an engineering degree in geology and mineralogy from Brigham Young University. Thereafter he was employed for many years by United States Steel in the field of mineral exploration before going with the Carnegie Museum. He retired from the museum in 1980 after serving for ten years as its curator of gems and minerals. Since 1980 he has been an independent gemological appraiser, a senior member of the National Association of Jewelry Appraisers, and a graduate gemologist. With such long and varied experience, Oswald is obviously a qualified expert in the field, but as set forth in

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our findings as curator of the museum he solicited the contributions from petitioners and has been a close personal friend and associate of Helfand for many years. Consequently, his appraisals also lack objectivity and cannot be accepted at face value.

Wilber also first appraised the opals for Australian Mining. Later, without reexamining the opals, he updated his appraisal and assigned values to the opals of the Schachters, Sokolows and the Kushes of $15,603.00, $24,843.60, and $57,768.75, respectively. He is a member of the National Association of Jewelry Appraisers and had been a gemstone dealer for 13 years at the date of his appraisals. Wilber has also served as a lecturer on the subject of gems and minerals. He has no formal training in gemstones or appraising and had been an appraiser for only two years when he first examined the opals. By the time of trial he had made approximately 50 appraisals of opals but only two were performed for clients other than Australian Mining. Here again we are unable to accept Wilber's appraisal at face value not only because of his limited experience, but because of lack of independence and objectivity.

The last appraisal was conducted by Bonanno and was limited to the free-form specimen of the Schachters. He did not testify at the trial, and we have no knowledge of his qualifications. Consequently, we are unable to attribute any weight to his conclusions.

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In addition to the shortcomings which we have already discussed with respect to petitioners' appraisals, we also note that in every case the appraisals were in excess of five times the actual purchase price paid by petitioners. With no evidence in the record tending to support such dramatic increases in value, we conclude that petitioners' appraisals are exaggerated to the point that the appraisals and their makers are not credible. See Chiu v. Commissioner, 84 T.C. 722, 734 (1985); Fuchs v. Commissioner, 83 T.C. 79, 99 (1984); Dean v. Commissioner, 83 T.C. 56, 75 (1984).

Although opinion evidence is obviously admissible and relevant on the question of value, we must weigh such evidence in the light of the demonstrated qualifications of the experts and of all other relevant evidence of value. Anderson v. Commissioner, 250 F.2d 242, 249 (5th Cir. 1957), affg. a Memorandum Opinion of this Court. Furthermore, we are not bound by the opinion of any expert witness when that opinion is contrary to our own judgment. Barry v. United States, 501 F.2d 578 (6th Cir. 1974); Tripp v. Commissioner, 337 F.2d 432 (7th Cir. 1964), affg. a Memorandum Opinion of this Court; Kreis' Estate v. Commissioner, 227 F.2d 753, 755 (6th Cir. 1955). We may embrace or reject expert testimony, whichever, in our best judgment, is appropriate. Helvering v. National Grocery Co., 304 U.S. 282 (1938); Silverman v. Commissioner, 538 F.2d 927, 933 (2d Cir. 1976), affg. a Memorandum Opinion of this Court.

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From the record before us we are satisfied that in each case both parties have failed to carry their burden of proof. In other words, from the record as a whole, we conclude that the most reliable and probative evidence of value is the purchase price paid by petitioners for the opals a little more than a year prior to their donation to the museum. See Chiu v. Commissioner, supra at 736; see also Estate of Kaplin v. Commissioner, 748 F.2d 1109, 1111 (6th Cir. 1984), revg. a Memorandum Opinion of this Court. Furthermore, no evidence was presented which tended to establish any circumstance or development justifying any increase or decrease in value between the purchase and the donation of the opals. Consequently, we find that the purchase price paid by petitioners in each case represents the fair market value of the opals on the date of the contributions.

We now turn to the issue of whether petitioners are subject to an addition to tax under section 6621(d) which provides for an increase in the interest accruing after December 31, 1984 where there is a "substantial underpayment." An underpayment is substantial if at least $1,000 of the underpayment in any taxable year is "attributable to 1 or more tax motivated transactions." Sec. 6621(d)(1) and (2). A "tax motivated transaction" is "any valuation overstatement (within the meaning of section 6659(c))." Sec. 6621(d)(3)(A)(i). Under section 6659(c), a "valuation overstatement" exists if the value of property claimed on a return is at least 150 percent greater than the amount determined to be the correct valuation of the property.

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In each of the cases before us at least $1,000 of the underpayment in tax is attributable to the overvaluation of the property donated to the museum. Furthermore, the value of the property reported on the return of petitioners in each case is greater than 150 percent of the amount we have determined to be the correct value of such property. From the record as a whole we are also satisfied that petitioners in each case were participants in a tax motivated transaction, i.e., a scheme to claim excessive deductions for charitable donations through the overvaluation of the contributed property. We conclude, therefore, that petitioners in each case are liable for the addition to tax provided by section 6621(d) and that they are not prejudiced by the fact that we have raised this issue sua sponte and post trial. See Johnson v. Commissioner, 85 T.C. 469 (1985).

Decisions will be entered under Rule 155.

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UNITED STATES TAX COURT

LDS, INC., TRANSFEREE OF THE ASSETS OF GLEN-TERRA, INC. AND SUBSIDIARIES, Petitioner v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 16839-84. Filed July 15, 1986.

Robert A. Wherry, Jr., for the petitioner.

Michael Cooper, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

FEATHERSTON, Judge: Respondent has determined that LDS, Inc., petitioner, is liable as transferee for income tax deficiencies in the amcunts of $2,481 and $305,327 of Glen-Terra, Inc. and subsidiaries for the taxable years ended December 31, 1977, and July 12, 1979, respectively. The parties have resolved

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certain adjustments and the only one remaining in dispute is an increase, determined by respondent, in the amount of $521,781 in the taxable income of Glen-Terra, Inc., and subsidiaries for the taxable year ended July 12, 1979. The correctness of respondent's determination turns on the following issues:

1. Whether the transfer by Glen-Vista, Inc., to Glen-Terra, Inc., of 7,090 acres of land on October 29, 1971, in exchange for a "note" was a sale or a nontaxable capital contribution.

2. Whether the extinguishment of the "note" as a result of a section 332[1] liquidation of Glen-Vista, Inc., into Glen-Terra, Inc., was a "disposition" of the note within the meaning of section 453(d), as then in effect.

FINDINGS OF FACT

At the time the petition was filed, petitioner's principal place of business was located in Colorado Springs, Colorado. For 1971, 1972, and 1973, Glen-Terra, Inc. (hereinafter Terra), and Glen-Vista, Inc. (Vista), each filed Federal corporate income tax returns. For each of the calendar years 1974 through 1978 and for the short taxable year ended July 12, 1979, Terra and its subsidiaries, including Vista, filed consolidated Federal income tax returns with the Internal Revenue Service.

In the early 1970's, Thomas Glennon (Glennon) was interested in investing in, promoting, and developing real estate. On March

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[1] All section references are to the Internal Revenue Code of 1954, as amended, unless otherwise noted.

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3, 1970, Glennon and others incorporated Vista with an initial capitalization of $10,000. Glennon contributed $5,000 and received 5,000 shares; M. H. Brinkerhoff contributed $2,500 and received 2,500 shares; and G. E. Stevens and H. S. Harmon each contributed $1,250 and each received 1,250 shares.

On March 9, 1970, Glennon entered into a contract with Robert E. Richards (Richards), an unrelated party, for the purchase of approximately 8,475 acres of land (the Fremont Land) for $400,000. On or before March 31, 1970, Glennon assigned his contract with Richards to Vista and Vista completed the contract.

Between March 31, 1970, and February 10, 1971, a dispute arose between Glennon, who wanted Vista to enter the "retail land business" and sell the Fremont Land in small lots, and the other shareholders, who wished to sell the Fremont Land in tracts of 40 acres or more. On February 10, 1971, Glennon resigned as president of Vista and organized Glen-Delco Corporation, which later changed its name to Terra and will hereinafter be so identified. The initial capitalization of Terra was $100, all of which was contributed by Glennon in exchange for 100 shares of common stock. From February 11, 1971, through July 12, 1979, Terra had only 100 shares of stock outstanding.

On or about February 12, 1971, Vista executed an option agreement which was designed to permit Terra to acquire parcels of Fremont Land from Vista to be sold in small 5-acre lots in Terra's retail land business. Some of the land was sold under this arrangement.

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On April 1, 1971, Glennon transferred his 100 shares of Terra stock and his 5,000 shares of Vista stock to his wife, Lillian Glennon (Mrs. Glennon). On July 1, 1971, G. E. Stevens transferred 625 shares of Vista's common stock to Zack Brinkerhoff, Jr. On September 16, 1971, Vista's stock was owned as follows:

Shareholder	No. of Shares
Zack H. Brinkerhoff, Jr.	625
G. E. Stevens	625
H. S. Harmon	1,250
M. H. Brinkerhoff	2,500
Mrs. Glennon	5,000
Total Issued and Outstanding Shares	10,000

On September 16, 1971, Vista agreed to redeem all of its stock not owned by Mrs. Glennon for $100,000 and 320 acres of the Fremont Land, which then had a value of about $75 per acre, to be selected by the redeemed shareholders. The redemption agreement was closed on September 27, 1971. On that date, Glennon was again elected president of Vista, and he held that position until July 11, 1979, when he resigned.

On October 29, 1971, Vista agreed to convey to Terra the remaining Fremont Land (the acreage not previously sold or transferred to Vista shareholders in redemption of their stock), consisting of approximately 7,090 acres. In this connection, Terra executed a note, payable to Vista, the body of which is as follows:

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$1,598,953.50 Denver, Colorado, October 29, 1971

IN INSTALLMENTS after date, for value received, the undersigned, jointly and severally, promise to pay to the order of GLEN VISTA, INC. at Denver, Colorado ONE MILLION FIVE HUNDRED NINETY EIGHT THOUSAND NINE HUNDRED FIFTY THREE AND 50/100 DOLLARS payable in installments with interest at 6 percent per a... on the declining balance.

IT IS AGREED by the makers and endorsers h reof that if this note is not paid when due or declared due hereunder, the principal and accrued interest thereon shall draw interest at the rate of 10 percent per annum, and that failure to make any payment of principal or interest when due or any default under any encumbrance or agreement securing this note shall cause the whole note to become due at once, or the interest to be counted as principal, at the option of the holder of the note. * * *

This transaction was reported on a schedule attached to Vista's calendar year 1971 Federal income tax return as an installment sale for a selling price of $1,598,953 and a gain of $1,299,887 on the sale (ratio of gain to contract price of .8130).

The Fremont Land was transferred from Vista to Terra by a series of deeds over a period of about 18 months. No downpayment was made and no security was given for the note. On Vista's and Terra's records, the amount of the purchase price was corrected to $1,604,683.50.

Terra had no source of funds for payment of the note except land sales. As sales of Fremont lots were made and the proceeds of the sales were collected, Terra made sporadic payments to Vista with respect to the unpaid balance of the note, together with interest thereon as follows:

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Period	Amount Paid	"Interest" Paid	Unpaid "Interest" Balance	Principal Paid	Principal Balance at End of Period
10/29/71--12/31/71	$ -0-	$ -0-	$ 15,990	$ -0-	$1,604,683
1/ 1/72--12/31/72	41,003	41,003	70,927	-0-	1,604,683
1/ 1/73--12/31/73	-0-	-0-	166,867	-0-	1,604,683
1/ 1/74--12/31/74	643,537	262,807	-0-	380,730	1,223,953
1/ 1/75--12/31/75	-0-	-0-	73,440	-0-	1,223,953
1/ 1/76--12/31/76	371,880	146,880	-0-	225,000	998,953
1/ 1/77--12/31/77	367,506	59,940	-0-	307,566	691,387
1/ 1/78--12/31/78	-0-	-0-	-0-	-0-	691,387
1/ 1/79--7/11/79	49,514	-0-	63,583	49,514	641,873
Totals	$1,473,440	$510,630		$962,810	

On December 31, 1973, Mrs. Glennon transferred her 5,000 shares of Vista stock to Terra. In 1974 and in 1976 Terra formed two new subsidiary corporations, Estates and Properties, respectively. The two new corporations as well as Terra sold the Fremont Land to the public in lots as "ranchettes."

Vista's Federal income tax returns for 1972 through 1979 (including the returns of Terra and subsidiaries) reported gain from the sale of the Fremont Land and included it in income. The Federal income tax paid by Vista, Terra, and subsidiaries for the

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taxable years ended December 31, 1971 through July 12, 1979, was approximately the same amount of tax as would have been paid by Vista, Terra, and subsidiaries (ignoring the Federal income tax on the $521,781 at issue in this case) had such transaction been treated as a capital contribution rather than as a sales transaction.

On July 11, 1979, Vista, Properties, and Estates were liquidated into Terra pursuant to section 332. At the time of Vista's liquidation, its basis for Federal income tax purposes in the unpaid balance of the note was $120,092, and the remaining "deferred gain," computed under section 453, as shown on Vista's financial records was $521,780. As part of the liquidation, Vista transferred the note to Terra. Terra's basis in the assets received from Vista was determined for Federal income tax purposes under section 334(b)(1).

On July 12, 1979, the Glennons transferred all of Terra's outstanding stock to petitioner. On the same date, Terra adopted a plan of liquidation whereby its assets were transferred to petitioner. To reflect the liquidation of Vista and Terra, and to close the books for tax computation purposes, a journal entry was made to reflect a reduction in Terra's tax basis in the remaining Fremont Land in the amount of $521,780.79. Prior to the transfer, LDS and its shareholders were unrelated to Terra and the Glennons.

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OPINION

Respondent contends that, on October 29, 1971, Vista sold land to its sister corporation and received a note which it elected on its 1971 return to treat as an installment obligation under section 453. In 1973, Vista became a wholly owned subsidiary of Terra and, in 1979, Vista was liquidated into Terra. As a result of the merger of debtor and creditor, the note was extinguished and, according to respondent, this extinguishment of the note was a section 453(d) "disposition" of the installment obligation. This disposition of the installment obligation caused the gain deferred as a result of the section 453 election to become taxable. Accordingly, Terra became taxable on deferred gain in the amount of $521,781 remaining on the unpaid balance of the note and petitioner is liable for such tax as transferee of Terra.

Petitioner concedes that it is a transferee of Terra but denies that Terra incurred any tax as a result of the extinguishment of the liability on the October 29, 1971, note. Petitioner contends that, although the documents relating to the transfer of the Fremont Land from Vista to Terra used the terminology of a sale, the transaction was in substance and in fact a capital or equity contribution to Terra. Under this view of the transaction, the provisions of section 453 never came into play and petitioner incurred no transferee liability when it received Terra's assets in the July 12, 1979, liquidation.

We hold for petitioner.

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Preliminarily, respondent maintains that petitioner is foreclosed from contending that the Vista-to-Terra land transfer was a capital contribution by the doctrine of Commissioner v. National Alfalfa Dehydrating & Milling Co., 417 U.S. 134 (1974). In that case the Supreme Court stated that it had "observed repeatedly that, while a taxpayer is free to organize his affairs as he chooses, nevertheless, once having done so, he must accept the tax consequences of his choice, whether contemplated or not, * * * and may not enjoy the benefit of some other route he might have chosen to follow but did not." 417 U.S. at 150. This is, of course, the general rule. The issue here, however, is the substantive character of the interest created by the Vista-to-Terra land transfer, i.e., a debt or an equity interest. Petitioner is simply arguing that the legal conclusion to be drawn from the objective facts is that, notwithstanding the labels attached, the transfer of property from Vista to Terra was in substance a capital contribution. This argument is not subject to the National Alfalfa rule.

In Selfe v. United States, 778 F.2d 769, 774 (11th Cir. 1986), the court of appeals recently explained the distinction as follows:

> Although the question whether a stockholder's advances to a corporation constitute debt or capital contributions is usually raised by the government, nothing in the Internal Revenue Code or our decisions suggests that the factors used to determine the substantive character of a taxpayer's interest in a corporation are available only to the government. See In re Lane, 742 F.2d at 1315; cf. Peter E. Blum, 59 T.C. 436, 439 (1972) (principles of resolving debt-equity determinations are consistent regardless of the context

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in which such determinations arise); J.A. Maurer, Inc., 30 T.C. 1273 (1958). Accordingly, where the nature of a taxpayer's interest in a corporation is in issue, courts may look beyond the form of the interest and investigate the substance of the transaction. These situations present an exception to the general proposition that a shareholder/taxpayer is bound by the form of her transaction. See Georgia-Pacific Corp. v. Commissioner, 63 T.C. 790, 795-96 (1975).

In Georgia-Pacific Corp. v. Commissioner, 63 T.C. 790, 795 (1975), cited above by the court of appeals, this Court stated that "while a taxpayer must in other contexts accept the tax consequences of the way in which he deliberately chose to cast his transaction," the determination of whether advances to a corporation are loans or equity contributions depends on the "economic reality for the year at issue." Accordingly, we must determine the economic realities of the Vista-to-Terra transfer of the Fremont Land.

Articulating the difference between an installment sale and a capital contribution of property to a corporation is no easy task. The problem is particularly difficult in the case of close corporations such as Vista and Terra, because the participants have broad latitude to cast their transactions in whatever form they choose and label them with terms not always consistent with economic realities. The courts have repeatedly stated, however, that "the labels that parties attach to their transactions provide no guarantee of the appropriate tax treatment." Slappey Drive Ind. Park v. United States, 561 F.2d 572, 581 (5th Cir. 1977); see also Tyler v. Tomlinson, 414 F.2d 844, 850 (5th Cir.

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1969). The decisive factor is not the terminology used in the documents but the economic substance of the transaction.

In determining whether a particular transaction creates a debt or an equity interest, the courts have considered a long list of factors, including: (1) the label given the instrument; (2) the presence or absence of a fixed maturity date; (3) the source of payments thereon; (4) the right to enforce payment of principal and interest; (5) participation in management flowing as a result; (6) the status of the contribution in relation to other creditors; (7) the intent of the parties; (8) "thin" or inadequate capitalization; (9) identity of interest between creditor and stockholder; (10) source of interest payments; (11) the ability of the transferee corporation to obtain loans from outside lending institutions; (12) the extent of the transferee corporation's other capital assets; and (13) the failure of the debtor to repay the loan on time or seek a postponement. Texas Farm Bureau v. United States, 725 F.2d 307, 311 (5th Cir. 1984); Fin Hay Realty Co. v. United States, 398 F.2d 694, 696 (3d Cir. 1968); see McSorley's, Inc. v. United States, 323 F.2d 900, 901-902 (10th Cir. 1963). These various factors are not equally significant. "The object of the inquiry is not to count factors, but to evaluate them.'" Tyler v. Tomlinson, 414 F.2d 844, 848 (5th Cir. 1969).[2]

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2 See also sec. 385(b) as follows:

> (b) Factors.--The regulations prescribed under this section shall set forth factors which are to be taken into account in determining with respect to a

(footnote continued)

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In the instant case, Terra was organized on February 10, 1971, with a capital of only $100 for which it issued 100 shares of its stock. This capitalization was obviously insufficient to permit it to engage in any substantial business activity or borrow money from outside sources. To become a viable entity, it needed capital. See Estate of Mixon v. United States, 464 F.2d 394, 410 (5th Cir. 1972). To obtain that capital, Terra's owner turned to Vista, a sister corporation.[3]

(footnote continued from previous page)
particular factual situation whether a debtor-creditor relationship exists or a corporation-shareholder relationship exists. The factors so set forth in the regulations may include among other factors:

> (1) whether there is a written unconditional promise to pay on demand or on a specified date a sum certain in money in return for an adequate consideration in money or money's worth, and to pay a fixed rate of interest,
>
> (2) whether there is subordination to or preference over any indebtedness of the corporation,
>
> (3) the ratio of debt to equity of the corporation,
>
> (4) whether there is convertibility into the stock of the corporation, and
>
> (5) the relationship between holdings of stock in the corporation and holdings of the interest in question.

No regulations under this provision are in effect. T.D. 7920, 1983-2 C.B. 69.

[3] This case does not raise the frequently litigated question whether the transfer of property between corporations with common shareholders produces a constructive dividend to the shareholders. A constructive dividend may result if the transfer is used directly or indirectly for the benefit of the shareholders. Joseph Lupowitz Sons, Inc. v. Commissioner, 497 F.2d 862, 868 (3d
(footnote continued)

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On October 29, 1971, only a few months after Terra was organized, Vista transferred to Terra 7,090 acres of the Fremont Land, without any downpayment, in consideration for a purported purchase price note of $1,598,953. As suggested above, the fact that the consideration was in the form of a note has little significance in determining the substance of the transaction. Terra's income, if any, between February 10, 1971, and October 29, 1971, was minimal, and its 1971 income tax return shows a loss of $30,289 for that calendar year. If the note was to be paid by this thinly capitalized new corporation, it could be paid only from profitable future sales of the Fremont Land itself. "If payment to the transferor is dependent solely upon the success of an untried, undercapitalized business, the prospects of which are uncertain, the transfer of property raises a strong inference that it is, in fact, an equity contribution." Burr Oaks Corp. v. Commissioner, 43 T.C. 635, 647 (1965), affd. 365 F.2d 24 (7th Cir. 1966); Estate of Mixon v. United States, supra at 404; Aqualane Shores, Inc. v. Commissioner, 269 F.2d 116, 119-120 (5th Cir. 1959), affg. 30 T.C. 519 (1958).

Although the land was purportedly purchased by Terra in consideration for the note, Vista received no downpayment and took no security for the note in the form of a mortgage or other

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(footnote continued from previous page)
Cir. 1974); Gilbert v. Commissioner, 74 T.C. 60, 64 (1980); Schwartz v. Commissioner, 69 T.C. 877, 884 (1978); Rapid Electric Co. v. Commissioner, 61 T.C. 232, 239 (1973); Rushing v. Commissioner, 52 T.C. 888, 893 (1969), affd. on other issues 441 F.2d 593 (5th Cir. 1971); there is no evidence that the Vista-Terra transfer benefited Mrs. Glennon personally. Her only benefit was a derivative one of using Vista's assets to capitalize Terra.

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lien. Rarely is real estate sold at arm's length on such terms. Moreover, the note provided no maturity date or payment schedule. Under Colorado law, the note, if a bona fide obligation, would be treated as a demand note. See Colo. Rev. Stat. 4-3-108 (1973); Thompson v. Hilleweart, 137 Colo. 107, 321 P.2d 623, 624 (1958). "While the issuance of a note may evidence bona fide indebtedness, an unsecured note due on demand with no specific maturity date, and no payment [schedule] is insufficient to evidence a genuine debt." Stinnett's Pontiac Service, Inc. v. Commissioner, 730 F.2d 634, 638 (11th Cir. 1984), affg. a Memorandum Opinion of this Court.

The transfer of the land to Terra was designed to give Terra an inventory of property, the only asset it held, for resale and to give it financial credibility. Glennon testified that one purpose of the land transfer was to strengthen Terra's marketing capabilities by putting "a sizeable asset on the balance sheet," thus facilitating the borrowing of funds and the factoring of commercial paper. The offsetting liability, he testified, could be explained as a debt "owed to the same people on both sides of the transaction." The land transfer thus gave Terra borrowing power which normally would have existed only through the presence of more adequate capitalization. Plantation Patterns, Inc. v. Commissioner, 462 F.2d 712, 722-723 (5th Cir. 1972), affg. a Memorandum Opinion of this Court. Because the transfer of the land to Terra was free and clear of any mortgage and Terra could use it as security for loans, Vista's note was in practical

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effect subordinated to the claims of Terra's creditors. See United States v. Henderson, 375 F.2d 36, 40 (5th Cir. 1967). In this manner, the Fremont Land was placed at the risk of Terra's business. Burr Oaks Corp. v. Commissioner, 43 T.C. at 647. Ordinarily, "shareholders place their money 'at the risk of the business' while lenders seek a more reliable return." Slappey Drive Ind. Park v. United States, 561 F.2d at 581; Midland Distributors, Inc. v. United States, 481 F.2d 730, 733 (5th Cir. 1973).

At the time of the transfer, moreover, Mrs. Glennon owned all of the stock of both Vista and Terra and thus controlled these brother-sister corporations. This identity of interests meant that collection of the purported note would not be enforced to Terra's detriment. When both the transferor and the transferee are commonly controlled, "the parties' framing of the transaction contributes little to the analysis." Slappey Drive Ind. Park v. United States, 561 F.2d at 583; see Fin Hay Realty Co. v. Commissioner, 398 F.2d 694, 697 (3d Cir. 1968).

We think it also significant that the purported purchase price had no relationship to the Fremont Land's value. Vista bought the land for $400,000, less than $50 per acre, in March 1970, about 18 months before the purported sale. On September 27, 1971, Vista completed the redemption of the stock of all its shareholders except Mrs. Glennon, in part for 320 acres of the land at a value of $75 per acre. One month later, Vista purportedly sold the remaining 7,090 acres for $1,598,953, over $200 per

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acre. The testimony shows that this purported price was grossly excessive, and an arm's-length sale would not have been made on such terms. Aqualane Shores, Inc. v. Commissioner, 30 T.C. at 526; Burr Oaks Corp. v. Commissioner, 43 T.C. at 640.

In support of his contention that the Vista-to-Terra transfer was a sale, respondent points out that the note was executed, the transaction was reflected as a sale on the accounting records of Vista and Terra, and the subsequent income tax returns report the payments as gains and interest from the sale, as described in our findings. While these facts tend to show the subjective intention of the individuals who controlled Vista and Terra that the transaction was to be a sale rather than a contribution of capital, they do not stand alone. For example, the deeds, executed over a period of months, when recorded were treated as capital contributions not subject to the full documentary fee. See Colo. Rev. Stat. 39-13-102. Moreover, the sporadic so-called payments on the note resembled dividends in that they appear to have been made only when excess funds were available to Terra and not according to any prearranged schedule. Thus, no payments were made in 1971, 1973, 1975, and 1978; substantial payments were made in 1972, 1974, 1976, 1977, and 1979.

At most, the terminology used and the accounting and tax treatment accorded the transaction by Vista and Terra show that the individuals in control of the two corporations subjectively intended the transfer to be a sale and that they followed through with that intention in keeping their records and filing their

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income tax returns. As a minimum subjective intent must be "weighed against the facts which support contrary inferences." McSorley's, Inc. v. United States, 323 F.2d 900, 902 (10th Cir. 1963); Crawford Drug Stores, Inc. v. United States, 220 F.2d 292, 296 (10th Cir. 1955). In Slappey Drive Ind. Park v. United States, 561 F.2d 572, 583 (5th Cir. 1977), the court explained:

> The question is not whether the parties intended to call their transaction "debt" * * *. Instead, the relevant inquiry is the actual manner, not the form, in which the parties intended to structure their relationship. If the intended structuring accords with the type arrangement that qualifies for taxation as debt, that intent supports a finding of debt. Here, however, the parties intended to structure their relationship in a manner placing funds at the prolonged risk of the businesses; they intended decisions whether to make payments on the advances to be based on the criteria usually associated with dividend decisions. To the extent that intent is relevant, it favors equity classification. [Fn. ref. omitted.]

In a number of cases, the courts have held, notwithstanding the form of the documents and the declared intention of the participants, that jury verdicts were not controlling where objective facts, comparable to those discussed above, demonstrated that the disputed transaction was a capital contribution rather than debt, see, e.g., Dillin v. United States, 433 F.2d 1097, 1100 (5th Cir. 1970); Berkowitz v. United States, 411 F.2d 818, 821 (5th Cir. 1969); cf. United States v. Snyder Brothers Co., 367 F.2d 980, 982-983 (5th Cir. 1966).

In this case, in summary, the objective facts overwhelmingly lead to the conclusion that the Vista-to-Terra land transfer was a capital contribution: (1) Terra was a newly organized

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corporation which had capital of only $100; (2) the transfer provided Terra with its start-up capital, an inventory of land which it could sell; (3) in addition to a sales inventory, the transfer provided Terra with property that it could use as security for the borrowing of funds and enabled it to factor commercial paper and thereby obtain funds for developing the land; (4) if the October 29, 1971, note were treated as a debt, the ratio of debt to other capital was over 15,000 ($1,598,953) to one ($100); (5) the "note" was unsecured and had no maturity date; (6) the note could be paid only from the proceeds of the profitable sale of the land transferred to Terra; (7) in substance Vista's note was subordinate to outside loans obtained by Terra; and (8) Vista and Terra were both owned, controlled, and managed completely by the Glennons, which meant that the note would not be enforced to Terra's detriment. In our opinion these factors constitute "strong proof" that the transaction was a capital contribution, see Ullman v. Commissioner, 264 F.2d 305, 308 (2d Cir. 1959), affg. 29 T.C. 129 (1957), and far outweigh the Glennons' subjective intent that the transaction was to be a sale of land to Terra.

Accordingly, Vista's transfer of the Fremont Land to Terra was a capital contribution and gain was not recognized when either Vista or Terra was liquidated. We need not, therefore, deal with the parties' argument under section 453.

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To reflect the foregoing,

Decision will be entered under Rule 155.

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T. C. Memo. 1986-294

UNITED STATES TAX COURT

EDWARD C. LEE and MARY C. LEE, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 3913-83. Filed July 17, 1986.

Edward C. Lee, pro se.

Wayne R. Appleman, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

WILBUR, Judge: Respondent determined the following deficiencies in, and additions to, petitioners' Federal income taxes:

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Year	Deficiency	Additions to Tax Sec. 6651(a)(1)[1]	Sec. 6653(a)
1976	$ 4,733	$ 797	$664
1977	4,190	1,048	678
1978	4,541	1,135	686

The issues for decision are:

(1) Whether petitioners had gross income as determined by respondent for the years 1976, 1977, and 1978.

(2) Whether petitioners are entitled to business bad debt deductions for amounts loaned to Spellbound U.S.A., Inc. during the years 1976, 1977 and 1978.

(3) Whether petitioners are entitled to a section 165 deduction on the sale of a seaplane for the year 1978.

(4) Whether petitioners' 1978 disposition of Hawaii real estate qualified for section 1031 treatment.

(5) Whether petitioners had capital gains from the sale of gold and silver coins for the years 1977 and 1978.

(6) Whether petitioners are liable for the additions to tax pursuant to section 6651(a)(1) for failure to file timely returns and section 6653(a) for negligence or intentional disregard of rules and regulations for the years 1976, 1977, and 1978.

Some of the facts have been stipulated and are found accordingly.

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[1] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954, as amended and in effect during the years in issue.

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Petitioner Edward C. Lee (hereinafter referred to as "petitioner") resided in Port Angeles, Washington, when the petition was filed in this case. Petitioner Mary C. Lee resided in Ocala, Florida, at that time. Petitioners were husband and wife during the years in issue.

Issue 1. Gross Income

FINDINGS OF FACT

Petitioner was employed as a pilot by Delta Airlines from 1969 through 1978. He received income from his employment at Delta Airlines during all of the years in issue and from other sources as well during the years 1977 and 1978.

OPINION

Petitioners raise as an issue whether they had any income which was taxable under the Internal Revenue Code. Essentially, they argue that the Federal Reserve notes they received in the years in issue are not reportable as income at their face value. It has been consistently held, however, that Federal Reserve notes constitute income at face value.[2] See United States v. Wangrud, 533 F.2d 495 (9th Cir. 1976), cert. denied 429 U.S. 818 (1976); Hatfield v. Commissioner, 68 T.C. 895, 897 (1977); Sibla v. Commissioner, 68 T.C. 422, 430-431 (1977), affd. without discussion of the issue 611 F.2d 1260 (9th Cir. 1980); Gajewski

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2 Petitioners raised the same argument in a previous case before this Court. We held the argument to be without merit. Lee v. Commissioner, T.C. Memo. 1981-26, affd. without discussion of the issue 723 F.2d 1424 (9th Cir. 1984).

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v. Commissioner, 67 T.C. 181, 193-194 (1976), affd. without opinion 578 F.2d 1383 (8th Cir. 1978). We will not waste our time discussing such hollow arguments which have been considered and rejected on numerous occasions.

Accordingly, we hold that in the years in issue petitioners had gross income which was taxable under the Internal Revenue Code.

Issue 2. Loss on Loans to Spellbound U.S.A., Inc.

FINDINGS OF FACT

During the period 1971 through 1973, petitioners loaned $31,159 to Spellbound U.S.A., Inc. Petitioner was appointed vice president and a director of Spellbound in 1971.[3] Neither petitioner owned stock in Spellbound and petitioner received no salary or compensation for acting as an officer and director. Petitioners' only expected profit from their involvement with Spellbound was the interest charged on the loans.

Spellbound was created and wholly owned by Sidney Hollister and Roberta Hudak. Spellbound's business activities included: (1) operating a hot dog stand in a Denver shopping center; (2) developing a mobile cart hot dog stand that was designed to be franchised; (3) operating a motel in Alamosa, Colorado; (4)

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3 There is evidence in the exhibits that petitioner was actually appointed as a director of Spellbound U.S.A., Inc.'s wholly-owned subsidiary, Spellbound U.S.A. of Southfork, Inc. Petitioner's testimony and respondent's requested findings of fact, however, both treat petitioner as a vice president and director of Spellbound U.S.A., Inc. The decision in this case would be the same assuming either fact to be correct.

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operating a bar and restaurant in Southfork, Colorado; and, (5) developing modular homes on land owned in Southfork. Petitioner made several trips to Spellbound's Colorado business locations.

Sometime in 1977 petitioners lost contact with Spellbound and its other officers. Petitioners did not know the location of Hollister and Hudak, the owners and remaining officers of Spellbound, and considered the debts to be uncollectible. Petitioners deducted the loss on the debts as business losses in the years 1976, 1977, and 1978 in the amounts of $12,000, $12,000, and $7,159, respectively. They used this allocation of the loss because it minimized their tax liability for these years. In his notice of deficiency, respondent determined that this loss was allowable only as a short-term capital loss in the year 1976 but did not dispute the amount of the loss.

OPINION

The primary issue is whether petitioners' loans to Spellbound are deductible as business bad debts or nonbusiness bad debts.

The Supreme Court has held that, "a loss attributable to the worthlessness of a debt shall be regarded as a bad debt loss, deductible as such or not at all." Putnam v. Commissioner, 352 U.S. 82, 88 (1956). Section 166(a) provides, in part, that "[t]here shall be allowed as a deduction any debt which becomes worthless within the taxable year." Section 166(d)(1) provides, however, that in the case of an individual, section 166(a) shall

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not apply to nonbusiness debts and that loss from the worthlessness of such debts shall be treated as a short-term capital loss. Section 166(d)(2) defines "nonbusiness debt" as "a debt other than--(A) a debt created or acquired * * * in connection with a trade or business of the taxpayer; or (B) a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business." For a bad debt to have the requisite "proximate" relationship to a taxpayer's trade or business, its creation must have been dominantly motivated by such trade or business. United States v. Generes, 405 U.S. 93, 103 (1972).

Petitioners contend that they have loaned money to two corporations with the intent of profiting from the loans and business activities. They further contend that the loans were directly related to petitioner's business as an officer and director of Spellbound and another corporation, their business of making loans or financing businesses, or their business of promoting corporate enterprises. Petitioners concluded that they are entitled to a business bad debt deduction for the amounts loaned to Spellbound. They also contend that the debts became uncollectible in 1977, although they attempted to deduct portions of the loss in 1976, 1977, and 1978.

Respondent contends that while petitioners intended to profit from their loans to Spellbound by earning interest, they were not in the business of making loans, financing businesses,

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or promoting corporate enterprises. Respondent notes that petitioner received no compensation for acting as an officer and director of Spellbound. Respondent reasons from the above that petitioners' activities with respect to the loans were in the nature of investment and not in the nature of carrying on a business. Respondent concludes that petitioners are limited to deducting their loss as a nonbusiness bad debt. Initially, respondent also contended that the debt had become uncollectible in 1976, but he has apparently conceded on brief that the proper year for deducting the loss was 1977.[4] We agree with respondent as to the character of the loss.

Petitioners have the burden of proof with respect to the characterization of the loss. Rule 142(a).[5] Petitioners must, therefore, provide sufficient evidence to prove that (1) they were engaged in a trade or business, and (2) the creation of the debt from which the loss arose was dominately motivated by such trade or business. Petitioners assert that their loans to

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4 In his notice of deficiency and in his opening statement at trial, respondent contended that the debt had become worthless in 1976. On both direct testimony and cross examination, petitioner stated that he had lost contact with the other officers of Spellbound in 1977 and believed that the debts had become uncollectible in that year. Respondent did not challenge petitioner's statements on cross examination and on brief requested that we find as a fact that petitioner lost contact with the people operating Spellbound sometime in 1977. We therefore assume that respondent has conceded the issue.

5 Unless otherwise indicated, all Rule references are to the Tax Court Rules of Practice and Procedure.

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Spellbound were proximately related to (1) their business of making loans or financing businesses, (2) their business of promoting corporate enterprises, or (3) petitioner's trade of being a corporate executive.

Relevant to petitioners' claim that they were in the business of making loans or financing businesses is our statement in Sales v. Commissioner, 37 T.C. 576, 580 (1961), that bad debts are deductible as business bad debts only in "exceptional situations where the taxpayer's activities in making loans have been regarded as so extensive and continuous as to elevate that activity to the status of a separate business." The record in this case does not indicate the number of loans made to Spellbound nor does it show that any significant business activities were involved in the making of the loans. Petitioners have asserted in their brief that, in addition to their loans to Spellbound, they made loans to another corporation. The record, however, contains no evidence of loans to any corporation other than Spellbound. Petitioners have failed to show that their activities in making loans were so "extensive and continuous" as to constitute a separate business.

Similarly, petitioners' claim that they were in the business of promoting corporate enterprises is not supported by the record. Petitioner made several trips to Spellbound's Colorado business locations but there is no indication in the record of his activities while on these trips. More importantly,

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petitioners have failed to demonstrate that such promotional activities would advance any business interest which they possess. They have not shown that they held an interest in Spellbound as property for sale to customers in the ordinary course of business, and, as we stated earlier, they have not shown that they were in the business of making loans.

Petitioner's claim that he was in the trade or business of being an employee of Spellbound is also unsupported. With respect to being an employee of a debtor corporation, it was stated in Whipple v. Commissioner, 373 U.S. 193, 204 (1963):

> Nor need we consider or deal with those cases which hold that working as a corporate executive for a salary may be a trade or business * * * [T]he contention would be groundless on this record since it was not shown that [taxpayer] has collected a salary * * * or that he was owed one. Moreover, there is no proof * * * that the loan was necessary to keep his job or was otherwise proximately related to maintaining his trade or business as an employee. * * * [Fn. reference omitted; citations omitted.]

In this case petitioner testified that he was not compensated, nor due compensation, for acting as a director and vice president of Spellbound. Petitioners admitted on brief that the positions entailed no specific duties. It is uncertain whether the evidence before us would establish that petitioner's employment with Spellbound was bona fide. Clearly, the evidence does not establish that petitioner's employment rose to the level of a trade or business.

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Petitioners have failed to show that they were engaged in any trade or business to which the loans to Spellbound were proximately related. Accordingly, we hold that they are limited to deducting their loss on these loans as nonbusiness bad debts in 1977.

Issue 3. Loss on Sale of Seaplane

FINDINGS OF FACT

In December 1974, petitioner purchased a seaplane as a first step toward starting a commercial seaplane operation in the Port Angeles area. Purchase of an aircraft is a prerequisite to obtaining an air taxi certificate from the F.A.A. The seaplane was purchased in Vermont with petitioner's personal funds. He had planned to fly the seaplane from Vermont to Port Angeles and there form a corporation which would own and operate the seaplane. On the flight from Vermont to the northwest, however, the seaplane developed engine problems. Petitioner incurred substantial expenses in overhauling the seaplane's engine, and it was not airworthy for approximately 3 years following its purchase. Before petitioner's seaplane was again airworthy, someone else had put a seaplane operation into service in the Port Angeles area and, as a result, petitioner decided to sell his seaplane. Petitioner sold the seaplane in 1978 at a loss.

In December 1975, petitioner formed ECL, Inc. with the intention of having it own and operate the seaplane. Because the seaplane was never available for operation in the Port Angeles

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area, petitioner did not transfer title to ECL. In 1979, petitioner changed the name of ECL to Peninsula Airlines, Inc. and began a commuter service between Port Angeles and Seattle. Peninsula Airlines ceased operations in May of 1980.

Petitioners claimed a business loss for the tax year 1978 equal to the loss realized on the sale of the plane and the expenses incurred in making it airworthy. Respondent disallowed the loss.

OPINION

At issue is whether petitioners' loss on the sale of the seaplane is deductible under section 165.

Section 165(a) allows a deduction for "any loss sustained during the taxable year and not compensated for by insurance or otherwise." Section 165(c), however, limits the deduction by individuals of noncasualty losses to (1) losses incurred in a trade or business or (2) losses incurred in transactions entered into for profit. Petitioner contends that the loss on the sale of the seaplane was an expense incurred in attempting to start a commercial seaplane service and that his motive in attempting to start up this service was to make a profit. Petitioner argues that his loss should be deductible as a business expense.

Conversely, respondent contends that petitioner is not entitled to a business loss deduction under section 165(c)(1) because he was engaged in neither the business of buying and selling planes nor the business of operating a seaplane service.

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Respondent further contends that petitioner is not entitled to a deduction under section 165(c)(2) for a loss incurred on a transaction entered into for profit because petitioner intended to contribute the plane to ECL, Inc. and did not intend to profit directly by its sale. Respondent also contends that, even if the loss were allowable, it would not be allowable until 1980 when ECL ceased operations. Respondent has not disputed the amount of the loss.

We hold that petitioners are entitled to a loss deduction in 1978 under section 165(c)(2). At the time the seaplane was sold petitioner had not established a trade or business in which the seaplane could be used, nor was petitioner in the business of selling seaplanes. Respondent, therefore, is correct in contending that a deduction is not available to petitioners under section 165(c)(1).

For a loss to be within section 165(c)(2), it must be incurred in a "transaction" and the transaction must be induced primarily by a profit motive. Seed v. Commissioner, 52 T.C. 880, 885 (1969). Respondent seems to contend that the purchase of property for contribution to a corporation owned by the purchaser is per se not a transaction induced primarily by a profit motive because there is no intention to directly profit from the property. In Horner v. Commissioner, 35 T.C. 231 (1960), the taxpayer purchased merchandise, using his own line of credit, for resale by his corporation. His expectation of profit was by way

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of the corporation's realizing a profit on the resale. When the corporation became insolvent the taxpayer was forced to pay the balance due on merchandise which had been transferred to the corporation. In holding that the taxpayer was entitled to a section 165(c)(2) deduction, we stated:

> Businesses or transactions entered into for profit can consist of many different types of activities. If one enters into the activity of furnishing a corporation with goods to sell, upon his own credit, with the expectation of deriving gain when the goods are sold he certainly is engaging in a transaction entered into for profit. In this case, the expectation was that the profits would come * * * either as salary as president and general manager, from dividends on his stock, or as an increase in the value of his stock. [Horner v. Commissioner, supra at 236.]

In the case before us, petitioner purchased the property with the intention of contributing it to the corporation and having the corporation realize a profit from the use of the property. As in Horner, the expected profits would presumably reach petitioner as either wages, dividends, or appreciation in the value of his stock. For the above reasons, we believe that petitioner had the requisite profit motive to entitle him to a loss deduction under section 165(c)(2). Because the seaplane was not held in a trade or business, this loss is a capital loss. Sections 1221, 1222.

Respondent further contends, however, that even if a loss is allowable it should not be allowed until 1980, the year in which ECL ceased operations. This is apparently based either on the idea that petitioner made a constructive contribution of the seaplane to ECL or that ECL had become liable to petitioner for his costs incurred in purchasing the seaplane. There is no

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evidence in this case that ECL ever acquired any rights or obligations with respect to the seaplane. Clearly, petitioner realized a loss on the sale of the seaplane and the loss is one described in section 165(c)(2). Section 1001(c) states that, "[e]xcept as otherwise provided in this subtitle, the entire amount of the gain or loss * * * on the sale or exchange of property shall be recognized." Respondent has failed to point out any provision which would prevent petitioner from properly recognizing his loss in the year of sale. Therefore, we conclude that petitioners are entitled to deduct the loss in 1978.

Issue 4. Gain on Disposition of Hawaii Real Estate

FINDINGS OF FACT

In 1961, petitioners purchased five parcels of land in Hawaii. The land was classified as agricultural by the State Tax Commissioner. In November 1977, petitioners purchased a farm in Washington from Ronald and Heidi Craig. In June 1978, petitioners sold each of the five parcels in Hawaii by statutory warranty deed. Each parcel was sold to a different purchaser but the deeds were executed on the same day. The proceeds from the sale of the land in Hawaii were transferred directly to Ronald and Heidi Craig as part of the purchase price of the Washington farm. The proceeds did not pass through petitioners' hands. None of the purchasers of the land in Hawaii were related to the sellers of the land in Washington.

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Petitioners realized a gain on the sale of the property in Hawaii. They did not, however, report this gain. Respondent determined that the gain should have been reported in 1978.

OPINION

The issue is whether the gain realized by the petitioners on the sale of their land in Hawaii is within the nonrecognition provisions of section 1031.

Section 1031 provides that, "[n]o gain or loss shall be recognized if property held for productive use in a trade or business or for investment * * * is exchanged solely for property of a like kind to be held either for productive use in a trade or business or for investment." Petitioners contend that the properties they purchased and sold were like kind and were held for investment or for productive use in a trade or business. They further contend that the purchase and sale were handled by a real estate broker as a single transaction and that, therefore, the gain realized on the sale of the Hawaii property was within the nonrecognition provisions of section 1031. Petitioners do not dispute the amount of the gain determined by respondent.

Respondent contends that these transactions were a sale of one property for cash followed by a separate investment of the proceeds and that such a transaction is not an exchange as required by section 1031. Respondent further contends that petitioners have failed to establish that the purchased farm was

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held for investment or for use in a trade or business. Respondent concludes that petitioners must recognize the gain on the sale of the Hawaii land in 1978. We agree with respondent.

Section 1031 has three requirements: (1) there must be an exchange; (2) the properties exchanged must be of like kind; and, (3) the property transferred and the property received must be held by the taxpayer either for use in a trade or business or for investment. Respondent has not argued in this case that the properties transferred were not of like kind. Respondent's regulations provide that if a person "exchanges city real estate for a ranch or farm, or exchanges a leasehold of a fee with 30 years or more to run for real estate, or exchanges improved real estate for unimproved real estate," the properties exchanged are of like kind. Section 1.1031(a)-1(c), Income Tax Regs. The property transferred and the property received in this case were both real estate and were clearly of like kind within the meaning of section 1031.

Respondent contends that there was no exchange in this case. An essential prerequisite for nonrecognition treatment under section 1031 is that there be an "exchange" of properties. A sale of one property for cash followed by a separate investment of the proceeds in like kind property does not qualify as an exchange. Barker v. Commissioner, 74 T.C. 555, 560-561 (1980). But in determining whether an exchange has occurred we look to the substance of a transaction rather than to the form in which

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it is cast. Biggs v. Commissioner, 69 T.C. 905, 914 (1978), affd. 632 F.2d 1171 (5th Cir. 1980). Where, as here, the transaction is a so-called "three-corner" transaction, contractual interdependence is not required. Biggs v. Commissioner, supra at 914. Such a transaction is within the ambit of section 1031 if the taxpayer's transfer and receipt of property "were interdependent parts of an overall plan, the result of which was an exchange of like kind properties." Biggs v. Commissioner, supra at 914.

Petitioners must demonstrate that the transfers of property in this case were interdependent parts of an overall plan in order for such transfers to constitute an "exchange" within the meaning of section 1031. The record in this case is nearly devoid of information about the interrelationship of the sales of the Hawaii property and the purchase of the Washington farm. The statutory warranty deeds executed upon the sale of the Hawaii property, entered by petitioners as exhibits, make no reference to the transfer or transferors of the Washington farm. Similarly, the escrow agreement and sales contract executed upon the purchase of the Washington farm, also entered by petitioners as exhibits, make no reference to the transfer or transferees of the Hawaii property. The purchase of the Washington farm occurred more than 7 months before the sale of the Hawaii property and petitioners have failed to show that the sale of the Hawaii property was even contemplated at the time of the purchase

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of the Washington farm. The only evidence showing a relationship between these transactions, other than petitioners' participation in them, is petitioner's testimony that the proceeds from the sale of the Hawaii land went directly to the sellers of the Washington farm. This evidence establishes nothing more than that the proceeds of the sale were used to pay a preexisting obligation of petitioners. The burden of proof is on petitioners to show that an exchange occurred within the meaning of section 1031. Rule 142(a). Petitioners have failed to satisfy this burden.

Petitioners also have failed to prove that the property acquired, the Washington farm, was to be held for productive use in a trade or business or for investment. The record contains no evidence as to the actual use of the farm. Petitioner testified that the land was classified as agricultural by either the State or county but this does not establish that the farm was, or was intended to be, used for agricultural purposes. Nor does the label "farm" tend to prove that the land was used for other than personal uses.

Petitioners have not demonstrated that the sale of the Hawaii property satisfied the requirements of section 1031. Accordingly, we hold that petitioners must recognize their gain on the sale of the Hawaii property in 1978.

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Issue 5. Gains from Sales of Gold and Silver Coins

FINDINGS OF FACT

On February 14, 1977, petitioners purchased 44 South African krugerands and 2 bags of silver coins from North American Coin and Currency, Ltd. of Phoenix, Arizona. In May and August of 1977, petitioners sold the two bags of silver at a gain. On January 12, 1978, petitioners sold the 44 krugerands at a gain.

Petitioners did not report these gains as income in 1977 or 1978. Respondent determined that these gains should have been reported as short-term capital gains in 1977 and 1978.

OPINION

The issue is whether petitioners must include the gains on the sales of these coins as income for 1977 and 1978.

Petitioners assert on brief that they received checks, not money, upon the sales of these coins. They contend that checks are personal property and, therefore, their gain must be computed using the fair market value of the checks. Petitioners conclude that because respondent failed to determine the fair market value of the checks, they are not required to include in income any gain from these sales.

Respondent contends that petitioners have the burden of proving that the fair market value of the checks differed from their face value. He further contends that petitioners have

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failed to satisfy this burden of proof and that, therefore, they must include in income gain computed by using the face amount of the checks. We agree with respondent.

Respondent's determination of a deficiency is presumptively correct and the burden is on petitioners to overcome this presumption. Welch v. Helvering, 290 U.S. 111, 115 (1933); Rule 142(a). Petitioners have offered no evidence to substantiate their claim that they received checks, rather than cash, on the sale of the coins. Prior to submitting their brief, petitioners' only objection to respondent's determination of gain was based on their claim that Federal Reserve notes are not legal dollars. As we stated earlier, this claim is completely without merit. On cross-examination, petitioner stated that, aside from his claim as to the status of Federal Reserve notes, the numbers assigned in respondent's letter of deficiency correctly represent petitioners' transactions in gold and silver coins during 1977 and 1978. While petitioner's statement was somewhat ambiguous, it seems to us to constitute an admission as to the accuracy of respondent's determination of the amounts realized on the sales. Regardless, petitioners have failed to overcome the presumption that respondent's deficiency determination is correct with respect to their sales of gold and silver coins in 1977 and 1978.

Accordingly, we hold that petitioners must include in income for 1977 and 1978 the gains realized on their sales of gold and silver coins.

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Issue 6. Additions to Tax Pursuant to Section 6651(a) and Section 6653(a)

FINDINGS OF FACT

Petitioner Edward Lee separately filed a Form 1040 (U.S. Individual Income Tax Return) with the Internal Revenue Service for the taxable year 1976. This form was received by the Internal Revenue Service on April 15, 1977. The form was signed by petitioner but stated only his name, address, and social security number. The spaces provided for information relating to income contained asterisks referencing a statement of objection at the bottom of the form. The two-line statement of objection purported to be a "specific objection" based on the Fifth Amendment, the theory that Federal Reserve notes are not United States dollars as defined by law, and the First, Fourth, Seventh, Eighth, Ninth, Tenth, Thirteenth, Fourteenth, and Sixteenth Amendments. The remaining spaces on the form either referenced similar objections, contained the word "NONE", or were left blank. The spaces provided for declaring income amounts all contained asterisks. The word "NONE" did not appear in any of these spaces. Documents attached to the Form 1040 raised various constitutional and political objections to income tax returns and taxation of Federal Reserve notes. Also placed on the return was the statement, "I offer to amend or refile this return exactly as

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you wish it, if you will please show me how to do so without waiving my Constitutional rights." No information relating to the computation of tax liability was included.

Prior to April 15, 1978, respondent received a Form 1040 separately filed by petitioner Edward Lee for the taxable year 1977. The form was signed and was filled out similar to that filed for 1976, but in place of the asterisks the spaces contained the phrase "OBJECT 5th." A statement at the bottom of the form explained that this phrase referred to an objection which was identical to the objection made on the form filed for 1976. Similar documents were attached to the form and an identical offer to amend or refile was made on the form.

On April 17, 1979, respondent received a Form 1040 separately filed by petitioner for the taxable year 1978. This form was signed by petitioner and listed petitioner's name, social security number, and claimed two exemptions. However, the form did not list petitioner's address. The remainder of the form was filled out similar to those filed for the previous 2 years with asterisks placed in most of the spaces. The same objection was made on the bottom of the form and the same offer to amend or refile was made at the top of the form. Similar documents were attached to the form.

In 1980, petitioner again filed a Form 1040 for each of the years 1976, 1977, and 1978. These forms designated filing status as married filing joint return but the spaces provided for

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spouse's signature indicated "out of state." These forms did include information necessary for computing petitioner's tax liability. Respondent received the form for 1976 on October 8, 1980, and the forms for 1977 and 1978 on June 19, 1980.

OPINION

The issue is whether petitioners are liable for the additions to tax pursuant to section 6651(a)(1) for failure to file timely returns and section 6653(a) for negligence or intentional disregard of rules and regulations for the years 1976, 1977, and 1978.

Section 6651(a)(1) imposes an addition to tax for failure to timely file a return unless the taxpayer shows that such failure was due to reasonable cause and not willful neglect. Section 6653(a) imposes an addition to tax if any part of an underpayment of tax is due to negligence or intentional disregard of rules and regulations. Respondent contends that the Forms 1040 filed by petitioner for the years 1976, 1977, and 1978 were not income tax returns within the meaning of the Internal Revenue Code and, therefore, petitioners have failed to timely file returns for each of the years in issue. Respondent further contends that petitioners' failure to file returns was due to willful refusal to comply with rules and regulations. We agree with respondent on both points.

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Courts have consistently held that a document filed as a return which does not contain sufficient information for respondent to compute and assess a tax liability is not a "valid return." Commissioner v. Lane-Wells Co., 321 U.S. 219 (1944); Edwards v. Commissioner, 680 F.2d 1268 (9th Cir. 1982); Cupp v. Commissioner, 65 T.C. 68 (1975), affd. without opinion 559 F.2d 1207 (3d Cir. 1977). This Court has held that a return within the meaning of the statute must "state specifically the amounts of gross income and the deductions and credits claimed." Conforte v. Commissioner, 74 T.C. 1160, 1195 (1980), affd. 692 F.2d 587 (9th Cir 1982). "[S]howing only a name, address, social security number, and date on a document falls far short of the information necessary to be shown on a return to enable respondent to compute and assess a tax." Cupp v. Commissioner, supra at 79. Clearly the Forms 1040 initially filed by petitioner for the years in issue did not contain sufficient information to constitute valid returns. These forms represent blanket refusals by petitioners to supply any information regarding their income and expenses cloaked in a veil of frivolous objections.

Because all of the spaces provided for declaring income amounts on each of these returns contained either asterisks or "OBJECT 5th," the holding in United States v. Long, 618 F.2d 74 (9th Cir. 1980), is not applicable to this case. In Long, the Court of Appeals for the Ninth Circuit, to which an appeal from

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our decision in this case lies, held that Forms 1040 on which the taxpayers had inserted zeros in the spaces provided for declaring income constituted valid returns. In the opinion of the Ninth Circuit, the Forms 1040 in issue therein were returns because they were not blank, but instead provided information, albeit false, in the form of zeros from which some computation of tax liability was possible.[6] In this case no information was provided on the forms which would allow respondent to compute a tax liability. Accordingly, we hold that the forms were not valid returns and petitioners are therefore liable for the additions to tax imposed by section 6651(a)(1).

Petitioners contend that they should not be required to provide the information requested on the Form 1040 because such would violate their privilege against self-incrimination. The privilege against self-incrimination may be asserted with respect to an Internal Revenue Service form only if a taxpayer shows a "relationship between the information required on the * * * form and a real and appreciable danger of criminal prosecution at the time he was required to complete that form." Rowlee v. Commissioner, 80 T.C. 1111, 1122-1123 (1983); see Hoffman v. United States, 341 U.S. 479 (1951). At trial, petitioner made

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6 This holding has been criticized and is not in line with the holdings of other courts. United States v. Mosel, 738 F.2d 157, 158 (6th Cir. 1984); United States v. Rickman, 638 F.2d 182, 184 (10th Cir. 1980); United States v. Moore, 627 F.2d 830, 835 (7th Cir. 1980); United States v. Smith, 618 F.2d 280, 281 (5th Cir. 1980).

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oblique references to past tax-related criminal charges. Petitioner did not establish any relationship between these criminal charges and the information requested on the Forms 1040 for the years in issue. Petitioners have not shown that any real and appreciable danger of criminal prosecution existed at the time they were required to complete these forms, and, therefore, are not entitled to claim the privilege against self-incrimination.

The burden of proof is on petitioners to establish lack of negligence or intentional disregard of rules and regulations. Bixby v. Commissioner, 58 T.C. 757, 791 (1972). The filing of protester returns by petitioner for the years in issue demonstrates that he was aware of his duty to file returns. Petitioner has not alleged that he was unaware of the rules and regulations requiring him to file returns. Rather, petitioner reasserts his constitutional objections to the questions on the Forms 1040. We find these objections to be frivolous and without merit. Petitioners have not shown that their failure to timely file returns for the years in issue was due to other than negligence or intentional disregard of rules and regulations. The evidence before us clearly suggests that their failure was

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due to willful disregard. Accordingly, we hold that petitioners are liable for the additions to tax under section 6653(a).

To reflect our conclusions with respect to the disputed issues,

Decision will be entered under Rule 155.

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T. C. Memo. 1986-295

UNITED STATES TAX COURT

ROBERT E. STEWART and GLORIA H. STEWART, Petitioners
v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket Nos. 16518-83, 26407-84.1/ Filed July 21, 1986.

John G. Gourlay, Jr., for the petitioners.

Robert W. West, for the respondent.

MEMORANDUM FINDINGS
OF FACT AND OPINION

KORNER, Judge: Respondent determined the following deficiencies and additions to petitioners' income taxes:

1/ These cases were consolidated pursuant to an Order of this Court dated April 3, 1985.

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Docket No.	Tax Year Ended	Deficiency	Additions to Tax Sec. 6653(a)(1) 2/	Additions to Tax Sec. 6653(a)(2)
16518-83	12/31/78	$73,279.80	$3,960.42	-
	12/31/79	31,604.02	1,580.20	-
	12/31/80	14,065.07	739.36	-
26407-84	12/31/81	51,874.88	2,593.74	*
	12/31/82	18,535.45	926.77	**

* 50 percent of the interest due on $51,874.88
** 50 percent of the interest due on $18,535.45

After concessions,3/ the only issues remaining for decision are the fair market values, for purposes of section 170(a), of three leasehold interests in real property donated in 1978 and 1981 by petitioner Robert E. Stewart to several charitable organizations.4/

2/ All statutory references are to the Internal Revenue Code of 1954, as in effect in the years in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure, except as otherwise noted.

3/ Petitioners did not present arguments in either their opening or reply briefs concerning the additions to tax for any of the years in issue. We therefore consider these items to be conceded. Rule 151(e); Calcutt v. Commissioner, 84 T.C. 716, 721-722 (1985); Bender v. Commissioner, T.C. Memo. 1985-375; Stonegate of Blacksburg, Inc. v. Commissioner, T.C. Memo. 1974-213.

4/ The deficiencies determined by respondent for 1979, 1980, and 1982, are the result of carryovers of charitable contributions made in previous years. Thus, our determination with respect to the fair market value of the items contributed in 1978 and 1981 will be determinative of the deficiencies for 1979, 1980, and 1982, as well.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. The stipulation of facts and exhibits attached thereto, as well as the oral stipulations made at trial, are incorporated herein by this reference.

Petitioners Robert E. Stewart (hereinafter petitioner) and Gloria H. Stewart, husband and wife, resided in Rankin County, Mississippi, at the time the petitions in docket Nos. 16518-83 and 26407-84 were filed. Joint Federal income tax returns were filed by petitioners for each of the calendar years 1978 through 1982.

Petitioner has been engaged in the business of home building and real estate development since 1961. In 1970, petitioner and his then 50 percent partner, Associated Constructors, Inc., began to purchase lands for the development of a residential subdivision in Rankin County. On February 2, 1972, as part of an acquisition of land for this project, petitioner and Joseph Campbell (Campbell), one of the principals of Associated Constructors, Inc., acquired the unexpired terms of two leasehold interests in what is commonly referred to as sixteenth section land.5/

5/ Sixteenth section land is land owned by the State of Mississippi and held in trust by the State for the support of public schools. The origin of sixteenth section land in Mississippi dates back to the formation of Mississippi as a state. At that time Congress directed that every sixteenth section of land in each township (or land designated in lieu thereof) was to be set aside and held in trust for school

(footnote continued)

To help provide for the needs of the subdivision, petitioner decided to locate a sanitary sewage lagoon on the leased sixteenth section land. In order to effectuate this plan, on August 28, 1972, petitioner and Campbell applied for an extension or renewal of the existing sixteenth section leases. The Rankin County Board of Supervisors (hereinafter the Board of Supervisors or the Board) thereupon appointed three persons owning land in Rankin County, to appraise the land and report to the Board.6/ Though none of the three people who were appointed were appraisers or held any interest in a sixteenth section lease, each of the three did own land in Rankin County in close proximity to the sixteenth section land at issue. The three recommended to the Board of Supervisors that the 443-acre tract be leased at a rate of $2.00 per acre per year. The Board, in its minutes dated September 5, 1972, stated that after receiving

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(footnote continued from previous page)
purposes. For a brief description of the history of sixteenth section land see Papasan v. United States, 756 F.2d 1087, 1089-1091 (5th Cir. 1985), affd. in part, vacated in part __ U.S. __ (July 1, 1986).

Prior to July 1, 1978, the sixteenth section land located within each county in Mississippi was to be administered by that county's board of supervisors for the benefit of that county's board of education. Sec. 29-3-1 Miss. Code Ann. (1972). The county boards of supervisors and the county boards of education consist of elected county officials. Effective July 1, 1978, the Mississippi Code was amended to give control of sixteenth section land to the county boards of education. Sec. 29-3-1 Miss. Code Ann. (1985).

6/ All of the 443 acres of the sixteenth section land desired to be leased were located outside any municipality in Rankin County. See infra note 13.

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this report and "having examined said report and inquired into the matter finds and determines that said sum of $886.00 per year represents the ground rental value of such land."

On September 5, 1972, the two existing leases were replaced with a new twenty-five-year lease having an annual rental rate of $2.00 per acre (hereinafter referred to as the Sixteen Section Lease). The only restrictions present in the Sixteenth Section Lease were as follows:

> It is expressly understood and agreed that the lessee shall have no right to sell and/or remove any sand, clay, gravel and/or dirt from the leased premises, and that all such sand, clay, gravel and dirt are hereby reserved from this lease, together with the right of ingress and egress to remove the same and all necessary or desirable rights in connection therewith.
>
> There is also reserved from this lease all timber, oil, gas and minerals now or hereafter on, in and under said land, with the right of ingress and egress to remove the same and all necessary or desirable rights in connection therewith.

Sometime after the Lease was entered into, petitioner formally requested the Board of Supervisors to allow him to remove timber from the land for the purpose of constructing the sewage lagoon. On January 7, 1974, the Board requested the Mississippi Forestry Commission to make an appraisal of the timber. During this same time period, petitioner, with the approval of the Board, also had an independent appraisal made.

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The Forestry Commission did not appraise the timber. Several interdepartment memoranda, written in the latter part of February 1974, indicate that the Commission was of the opinion that the sale was improper because, in its view, the land was classified as forest land. The sale to petitioner, however, did occur, with petitioner paying the independently appraised price to the Rankin County Board of Education. Sometime thereafter, the timber was removed and petitioner began construction of the sewage lagoon. When the Forestry Commission learned of the sale, it issued a letter to the Board, recommending, inter alia, that petitioner's lease be canceled, and that petitioner be charged double the value of the timber in view of the questionable nature of the sale. No action was taken, however, to cancel the lease.7/ Construction of the lagoon was completed in 1974 and the lagoon has been in continuous operation ever since.

There were also two abandoned sand pits located on the sixteenth section land. On June 21, 1976, the Board granted Cox Construction Co., Inc. the right to remove sand and sand-clay topping from the sand pits, in exchange for a payment of $0.11 per cubic yard removed. On December 22, 1978, following the submission of sealed bids, petitioner, as highest bidder, was granted by the Board the right to remove and sell sand and/or sand-clay topping from the sixteenth section land in exchange for a payment of $0.11 per cubic yard removed. Petitioner

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7/ The record does not indicate whether the additional amount was paid.

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subsequently removed and sold approximately 3,288 cubic yards of sand to an unrelated third party at a rate of $0.25 to $0.30 per cubic yard.

Through a series of transfers, on July 28, 1975, petitioner became the sole owner of that portion of the Sixteenth Section Lease pertaining to a 40-acre tract and that portion pertaining to an adjoining 3.8-acre tract. On that same date he also became a 70 percent owner of that portion of the Lease relating to a 30-acre tract.

On December 28, 1978, petitioner conveyed his leasehold interest in the 40-acre tract to the Rankin County School District for $1.00.[8/] The Northeast Rankin Attendance Center School was subsequently constructed on the said property. On their 1978 tax return petitioners claimed a charitable contribution deduction based on an estimated value for the leasehold interest of $243,500.00. This deduction was disallowed by respondent, who allowed a charitable deduction of only $669.19.

On January 10, 1981, petitioner conveyed his 70 percent leasehold interest in the 30-acre tract to the Rankin County YMCA for $1.00.[9/] Petitioner conveyed his entire leasehold interest

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8/ The instrument of conveyance contained the following language: "It is understood and agreed that the above described property [i.e., the 40-acre tract] is to be used as a site for a public school."

9/ The instrument of conveyance contained the following language: "It is understood and agreed that the above described (footnote continued)

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in the 3.8-acre tract to the Rankin County School District for $1.00 on April 1, 1981. On their 1981 tax return, petitioners claimed charitable contribution deductions based on estimated values for these leasehold interests of $147,000 and $27,720, respectively. These deductions were disallowed by respondent, who allowed a charitable deduction of only $378.66.10/

On September 5, 1972, the fair rental value of the property underlying the Sixteenth Section Lease was $25 per acre per year.

OPINION

The ultimate issue for decision is whether petitioners are entitled to charitable deductions, pursuant to section 170(a), in excess of the amounts allowed by respondent, for contributions made in 1978 and 1981 of leasehold interests in a 40-acre tract, a 30-acre tract, and a 3.8-acre tract of sixteenth section land.

There is no dispute here that the donations were in fact made to qualified donees under section 170(c). To determine the allowable deduction, however, we must determine the fair market

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property [i.e., the 30-acre tract] is to be used for a non profit YMCA Program. In the event the Assignee does not use the aforedescribed property as part of its YMCA program, then said property shall revert back to the Assignor, Robert E. Stewart, at the end of five years."

10/ The allowance in the statutory notice of deficiency for docket No. 16518-83 apparently represents the present value of $2 per acre that petitioner may have been required to pay as rent on the 40-acre tract for the remainder of the leasehold. In docket No. 26407-84, respondent's allowance with respect to the leasehold interests in the 30-acre and 3.8-acre tracts were apparently for similar reasons.

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value of the donated property, to wit, "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having a reasonable knowledge of relevant facts." Sec. 1.170A-1(c)(2), Income Tax Regs. Resolution of this issue depends, in turn, on the threshold question of whether the Sixteenth Section Lease, including the donated portions thereof, was a valid lease having any ascertainable value. In making this determination we must look to Mississippi law, as interpreted by the highest court of that state. Aquilino v. United States, 363 U.S. 509, 512-413 (1960); Morgan v. Commissioner, 309 U.S. 78, 80 (1940); Commissioner v. Estate of Bosch, 387 U.S. 456, 465 (1967).

Petitioners contend that the Sixteenth Section Lease was properly executed in accordance with the provisions of the Mississippi Code, that the rent prescribed in the lease was fair and adequate, and that, accordingly, the lease was valid in every respect.[11] Respondent, on the other hand, asserts that the

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11/ Sec. 15-1-7 of the Miss. Code Ann. (1972) provides that an action to recover land shall not be made except within ten years following the time at which the right to bring the cause of action accrued. Petitioners urge that pursuant to sec. 15-1-7, any suit brought to void petitioner's lease would have had to have been filed no later than September 2, 1982. Therefore, argue petitioners, this Court cannot consider an issue which a Mississippi court would be barred from hearing.

We disagree. Without deciding whether sec. 15-1-7 governs the instant matter, for valuation purposes the critical dates are the dates of the donations, December 28, 1978; January 10, 1981; and April 1, 1981. Johnson v. Commissioner, 85 T.C. 469, 478 (footnote continued)

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consideration in the lease was grossly inadequate, and that therefore, the lease was void ab initio under Mississippi law.

Petitioners direct our inquiry to section 29-3-52 of the Mississippi Code which provides:

> Any lease of sixteenth section lands, or lands granted in lieu thereof, executed and recorded in substantial conformity with the provisions of this chapter shall be deemed to be prima facie valid, and defects in ministerial or procedural acts alone shall not affect the validity of any such lease, as far as a bona fide purchaser or encumbrancer for value of any such lease is concerned. Any such purchaser or encumbrancer shall be entitled to rely upon the validity of any such lease insofar as the interest of the state or any political subdivision thereof, the public, or any school district is concerned.
>
> Nothing in this section shall prohibit any party from challenging the validity of any lease on the grounds of inadequacy of consideration given for the lands involved in the lease. [12/] [Miss. Code Ann. sec. 29-3-52 (1985)]

Petitioners also note that the Supreme Court of Mississippi has indicated that the Board of Supervisors, in carrying out its responsibilities in leasing sixteenth section land, is presumed to have complied with the laws of Mississippi. Edwards v. Harper, 354 So.2d 256, 258 (Miss. 1978).

(footnote continued from previous page)
(1985); sec. 1.170A-1(c)(2), Income Tax Regs. Thus, even if the ten-year limitation period applies, the statute was still open at the time the gifts were made, and we are therefore not precluded from considering this issue.

12/ This section was enacted to be effective on and after July 1, 1978. Although it has not, as yet, been interpreted by the Mississippi Supreme Court, a special assistant to the Mississippi Attorney General testified at trial that the statute would apply to leases existing on July 1, 1978.

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Here the Lease was executed in substantial conformity with the provisions of Mississippi law and thus we are of the opinion that the Mississippi Supreme Court would find the Lease to be prima facie valid under the first paragraph of the above statute. When the Sixteenth Section Lease was renewed, the Board of Supervisors, purportedly acting in compliance with section 29-3-65 of the Mississippi Code (as in effect on September 5, 1972 -- the date the lease was renewed), appointed three persons owning land in Rankin County, in close proximity to the sixteenth section tract in issue, to appraise the rental value of the property.13/ These three people recommended $2.00 per acre per year as an appropriate rental value for the 443-acre tract. The Board of Supervisors determined that $2.00 per acre per year was a reasonable rental rate, and re-leased the sixteenth section tract at that rate for a term of 25 years.

However, this is not the end of our inquiry. As respondent correctly points out, the above-quoted provisions of section 29-3-52 of the Mississippi Code indicate that the validity of a sixteenth section lease may be challenged on the grounds of

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13/ Section 29-3-65 of the Miss. Code Ann. (1972), as in effect on the relevant date, required that when any sixteenth section land situated within a municipality became subject to lease, the board of supervisors was to appoint "three disinterested free-holders" of their county to appraise the rental value of said property. As is indicated in our findings, the sixteenth section land in the instant matter was located outside a municipality. The Mississippi Code is silent as to the appraisal of sixteenth section land in this instance.

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inadequate consideration.14/ In fact, the Mississippi Supreme Court has held on several occasions that a lease of sixteenth section land to a private individual by the board of supervisors -- who act as trustees in administering the property -- is void where the lease is for a grossly inadequate consideration, because in that case there has been, in effect, a donation of public property to a private person in violation of Article IV, section 95, of the Mississippi Constitution. See, e.g., Keys v. Carter, 318 So.2d 862, 864 (Miss. 1975); Holmes v. Jones, 318 So.2d 865, 869 (Miss. 1975). Thus, we are faced with the difficult task of determining whether the consideration required to be paid as rent in the Sixteenth Section Lease was grossly inadequate.

Precise guidelines have not been established for determining whether consideration is grossly inadequate, as this court-created concept has evolved on a case-by-case analysis. The Supreme Court of Mississippi has indicated in several instances involving sixteenth section leases that the consideration stated in the lease was grossly inadequate. In Tally v. Board of Supervisors of Smith County, 353 So.2d 774, 775 (Miss. 1978), for example, the court stated in dictum that the consideration was

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14/ It is also noteworthy that the statute, on its face, speaks in terms of "defects in ministerial or procedural acts." At trial the special assistant to the State Attorney General confirmed that the purpose of the statute was to prevent challenges as to the validity of these leases based solely on technical defects contained in the lease. Hence, there is additional support for an inquiry as to the adequacy of the consideration in the Sixteenth Section Lease.

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grossly inadequate when sixteenth section land was leased at rates ranging from twenty cents per acre to eighty-two cents per acre (apparently per year). The court resolved this controversy on another issue, however, and as such, made no mention of the fair rental value of the property. In Holmes v. Jones, supra, the court held that a prima facie case was stated against the Board of Supervisors because the consideration in a lease of 150 acres of sixteenth section land in Rankin County was grossly inadequate. In that case the fair rental value of the property was stated to be $900 per year and the rent required in the lease was $37.50 per year -- a fair-market-value-to-stated-value ratio of 24 to 1. 318 So.2d at 869. In Keys v. Carter, supra, the court was again faced with determining the validity of a sixteenth section lease in Rankin County. In response to a general demurrer, the court stated that if, as alleged, the consideration required to be paid in the lease of a 320-acre tract was $170 per year, when the fair rental value of the land was $4,000 per year (a ratio of 23.53 to 1), then the lease must be held to be void. 318 So.2d at 864.

Conversely, a sixteenth section lease was not held to be invalid in Edwards v. Harper, 354 So.2d 256, 258-259 (Miss. 1978), where the court determined that the stated consideration of $400 for a ninety-nine-year lease of seventy-five acres of sixteenth section land was a reasonable rental. The court also indicated, albeit reluctantly, in another action involving the

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Board of Supervisors of Smith County, Tally v. Board of Supervisors of Smith County, 323 So.2d 547, 551 (Miss. 1975), that it would not hold as a matter of law that a yearly rental of forty cents per acre for sixteenth section land was grossly inadequate. In that case, however, the court was not presented with evidence as to the fair rental value of the property.

Along this same line, the Supreme Court of Mississippi has expressed the view that the fair market value of timber removed from sixteenth section land may be recovered by the state where the timber has been sold for grossly inadequate consideration. In this context, the court has indicated that a sale price of $500 for sixteenth section timber worth $4,000 (a ratio of 8 to 1) was consideration so grossly inadequate as to render the sale virtually a donation of public property within the prohibitions contained in the state constitution. State v. Dear, 212 Miss. 620, 55 So.2d 370, 374 (1951). See State v. Dear, 209 Miss. 268, 47 So.2d 150 (1950); State v. Dear, 209 Miss. 268, 46 So.2d 100 (1950); see also Koonce v. Board of Supervisors of Grenada County, 202 Miss. 473, 32 So.2d 264 (1947). The court has also applied this concept to other actions involving state-owned land. In State v. Tate, 188 Miss. 865, 196 So. 755 (1940), for instance, a suit was brought to cancel a patent purporting to convey the state's title to forty acres of land. The court canceled the patent, ruling that it was invalid because the consideration paid ($45) was grossly inadequate when compared to

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the fair market value of the land ($200) (a ratio of 4.44 to 1). 196 So. at 757. Likewise, in State v. Adams, 185 Miss. 606, 188 So. 551 (1939) the amount paid for a patent to convey land ($160) was held to be grossly inadequate when it was compared to the fair market value of the land ($1,600) (a ratio of 10 to 1.)[15/]

In the instant matter, respondent's expert witness has provided us with evidence indicating that on the date that the Sixteenth Section Lease was entered into[16/] (September 5, 1972), the annual fair rental value of the property was $25 per acre, and we have accepted it as the basis for our finding as to the fair market value of the lease. Respondent's expert witness, Jerry D. Mask, has been engaged in the real estate appraising business in the Mississippi area since 1965. Mask estimated the fair rental value of the entire sixteenth section tract as of

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15/ For cases dealing with nonstate-owned land see Mathews Brake Hunting & Fishing v. Sneed, 475 So.2d 811 (Miss. 1985) (evidence supported a finding that a fixed agreed-upon price of $4,132.89 for the surrender of a share in a corporate hunting and fishing club, was grossly inadequate when the fair market value of the share was $21,000 -- a 5.01 to 1 ratio); Central Financial Services Inc. v. Spears, 425 So.2d 403 (Miss. 1983) (foreclosure sale price of $1,458.86 held to be grossly inadequate where twelve days later property sold for $4,000 -- a 2.74 to 1 ratio); Lampley v. Pertuit, 199 So.2d 452 (Miss. 1967) (consideration was held to be grossly inadequate where real property was sold for $400 when the fair market value ranged from $1,650 to $2,000 -- a 5-4.125 to 1 ratio); Hesdorffer v. Welch, 127 Miss. 261, 90 So. 3 (1921) (sale of real property set aside on grounds of grossly inadequate consideration where foreclosure sale price was $100 but resale price was $1,200 -- a 12 to 1 ratio).

16/ The appropriate valuation date to be used in determining whether the stated consideration was grossly inadequate is the date on which the lease was entered. See Edwards v. Harper, 321 So.2d 301, 303 (Miss. 1975).

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September 5, 1972, and also estimated the value of the leasehold interests in the 40-acre and 30-acre tracts as of 1978 and 1981, respectively. Here, as with petitioners' expert, we need only review the methodology used in arriving at the fair rental value for the entire tract in 1972. In making this determination, Mask reviewed 16 sales of nonsection sixteenth section land, with plot sizes ranging from 38 acres to 799 acres, and sales prices ranging from $425 per acre to $5,500 per acre. The location of each sale was in the general vicinity of the sixteenth section land, and the sales occurred during each of the years 1971 through 1976, as well as in 1978. Based on the above information Mask determined that on September 5, 1972, the fee interest in the sixteenth section tract was worth $500,000. Mask then determined that because of the limitations inherent in sixteenth section land (prohibitions on sale, waste, certain uses), a lessor could only expect a 5-percent rate of return. He accordingly determined that the fair rental value of the property on September 5, 1972, was $12,500 per year ($500,000 X 5% = $12,500) or $25 per acre per year.17/

17/ In his valuation report Mask arrived at $25 per acre per year as the fair rental value of a 500 acre plot of sixteenth section land. In fact, the lease covered only 443 acres. At trial, Mask explained that because a per acre value was estimated, the $25.00 figure was correct regardless of whether 500 acres or 443 acres were involved.

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The accuracy of the data relied on by respondent's expert is not disputed by petitioner.[18] Instead, petitioners rely on evidence presented by their own expert. J.H. Thames, Jr. has served as a real estate appraiser in the Mississippi area since 1968. In his valuation report Thames examined five leases of

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18/ Petitioners do argue that as a result of Barber v. Turney, 423 So.2d 133 (Miss. 1982), the method used by respondent's expert in arriving at the fair rental value could not have been used by the Board of Supervisors, and thus should not be used here. This contention is incorrect, primarily for two reasons: First, in Barber, the court was interpreting sec. 29-3-63 of the Miss. Code Ann. (1985), which apparently requires that certain sixteenth section land may not be leased or re-leased at a rate of less than five percent of the appraised rental value. That section has no application here, as it applies only to negotiations for leases or for extensions occurring on or after July 1, 1978. See Miss. Code Ann. sec. 29-3-63; Opinion of the Attorney General of Mississippi, dated May 23, 1985. Second, and more importantly, in Barber, the Board of Education appointed an appraiser to determine the fair rental value of a tract of sixteenth section land for the purpose of re-leasing said land. The appraiser determined that the fair market value of the fee interest in the land was $225. He then recommended to the Board that the land be leased at five percent of $225 or $11.25 per acre per year. Though the court required a new appraisal to be made, it indicated that:

> the Board has the final authority, duty and responsibility to determine the reasonable annual rental amount to be assessed on sixteenth section lands, and it is not bound by a percentage of fair market sale value or fair market rental value of the land. The Board is simply required to lease the sixteenth section land for the fair rental value thereof. Such is required in order for the Board to absolve itself of liability for inadequate rentals. [423 So.2d at 135-136; fn. ref. and citations omitted.]

The court clarified its position further in Turney v. Marion County Bd. of Educ., 481 So.2d 770 (Miss. 1985) where it stated that:

> Barber did not hold that the Board is precluded

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sixteenth section land executed by the Board of Supervisors which were each entered into at approximately the same time as the Sixteenth Section Lease. The annual per acre lease rates of these tracts varied from $0.25 per acre to $1.25 per acre. Thames concluded his report by stating:

> It is my opinion that the $2.00 per acre per year lease amount represents a comparable price based on other leases made in the same time period. This does not represent market rent based on arms length transactions between private individuals but based on the past actions of the Board of Supervisors.

As is indicated above, petitioners' expert's report merely recited evidence of the consideration required in other Rankin County leases, but specifically disclaimed any opinion as to whether the consideration required in the Sixteenth Section Lease represented a reasonable market value. The value relied on by petitioners was neither realistic nor the result of arm's-length negotiations, and thus, is entitled to little, if any, weight.

In light of the foregoing, we are not convinced that the Mississippi Supreme Court would hold the Sixteenth Section Lease to be valid. Accepting the $25 per acre per year figure as the

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> from using the percentage of fair market sales value method if that method best yields fair rental value. Barber simply holds that the Board is not bound to use that method. The Board may choose its own method of valuation as long as the evaluation results in the fair market rental value of the subject land. [481 So.2d at 779; emphasis in original.]

Thus, we find petitioners' arguments to be unpersuasive.

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fair rental value of the property, the fair-market-value-to-stated-value ratio in this case is 12.5 to 1 (25 ÷ 2 = 12.5). A review of the Mississippi cases cited above shows that a ratio of such a large magnitude would probably fall within the "grossly inadequate" standard articulated by the Mississippi Supreme Court. In fact, in no less than three of the cases involving state-owned property, the stated consideration was held to be grossly inadequate where the ratio was less than 12.5 to 1. An examination of the cases involving nonstate-owned property similarly yields at least four cases where the consideration was held to be grossly inadequate when the ratio was 12 to 1, or less. The two cases involving sixteenth section land where the court refused to find that the stated consideration was grossly inadequate, Edwards v. Harper, supra, 354 So.2d at 258-259, and Tally v. Board of Supervisors of Smith County, supra, 323 So.2d at 551, are simply not applicable. In those cases, unlike here, the court was not presented with evidence that the fair rental value of the property was different from that stated in the lease.19/

19/ If the consideration in a sixteenth section lease is found to be grossly inadequate the appropriate remedy is to hold the lease to be void. See, e.g., Keys v. Carter, 318 So.2d 862, 864 (Miss. 1975); Holmes v. Jones, 318 So.2d 865, 869 (Miss. 1975). This is true whether the board of supervisors executed the lease through negligence, fraud, or collusion. State v. Dean, 209 Miss. 268, 46 So.2d 100, 104 (1950); Koonce v. Board of Supervisors of Grenada County, 202 Miss. 473, 32 So.2d 264, 265 (1947).

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In this case, because a deduction is involved, the burden of proof is upon petitioners not only to show error on the part of respondent, but also to prove the amount of the claimed deductions. Bennett Paper Corp. v. Commissioner, 699 F.2d 450 (8th Cir. 1983), affg. 78 T.C. 458 (1982); Rockwell v. Commissioner, 512 F.2d 882 (9th Cir. 1975), affg. a Memorandum Opinion of this Court, cert. denied 423 U.S. 1015 (1975); Estate of Finder v. Commissioner, 37 T.C. 411, 423 (1961). Here, petitioners had to prove the value of the portions of the Sixteenth Section Lease which they contributed to charitable donees in 1978 and 1981. Such values, in turn, depended upon whether petitioners had a valid lease in the first place. We do not hold that the Sixteenth Section Lease here was invalid, but, given our study of the Mississippi cases in this area, we have the gravest doubts about it, and we do hold that petitioners have failed to carry their necessary burden of proof to show that the lease was valid, that the values as claimed by them in their returns were correct, and that respondent's determination was erroneous in this respect.20/

To reflect the foregoing,

Decisions will be entered for the respondent.

20/ As we have resolved the threshold question in favor of respondent, we need not reach the parties' contentions with respect to date-of-gift values of the respective donations.

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T. C. Memo. 1986-296

UNITED STATES TAX COURT

ESTATE OF LAWRENCE B. MANGIONE, DECEASED, PETER L. MANGIONE, EXECUTOR, Petitioner v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 31883-83. Filed July 21, 1986.

Martin S. Korey and Sherwin I. Pogrund, for the petitioner.

Vikki L. Pryor, for the respondent.

MEMORANDUM OPINION

FAY, Judge: Respondent determined a deficiency in petitioner's Federal estate tax liability in the amount of $90,764.42. After concessions, the sole remaining issue is whether the value of a condominium unit included in the gross estate should be reduced for estate tax purposes by reason of a State Probate Court order granting decedent's surviving spouse rent-free use, possession and occupancy of the condominium unit.

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This case was submitted fully stipulated pursuant to Rule 122.[1] The stipulation of facts and attached exhibits and the supplemental stipulation of facts are incorporated herein by reference.

Lawrence B. Mangione (herein "decedent") died on September 28, 1980. Petitioner timely filed a Federal estate tax return on June 29, 1981, with the District Director of Internal Revenue at Chicago, Illinois. At the time of the filing of the petition herein, Peter Mangione, decedent's son and executor of decedent's estate, resided in Glenview, Illinois.

At the time of his death, decedent owned one hundred percent of the beneficial interest in a revocable land trust with American National Bank and Trust Company of Chicago, as trustee, under a trust agreement dated November 1, 1974 (herein "land trust"). At the time of decedent's death, the corpus of the land trust was a condominium unit known as Unit No. 104, 1740 North Mission Hills Road, Northbrook, Illinois. The remaindermen to the land trust were decedent's son and daughter. Pursuant to the agreement creating the land trust, either decedent or Peter Mangione had the power to terminate the land trust or transfer the corpus thereof at any time before decedent's death.

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[1] All Rule references are to the Tax Court Rules of Practice and Procedure. All section references are to the Internal Revenue Code of 1954, as amended and in effect at the time of the decedent's death.

On June 1, 1977, decedent married Erma Bartling (herein "Erma") and remained married to her until his death. On May 25, 1977, decedent and Erma had entered into an antenuptial agreement whereby Erma waived all rights in decedent's property that she might have acquired by reason of her marriage to him, and specifically agreed not to share in decedent's estate by way of dower or curtesy, or by way of her statutory allowance.

On September 15, 1977, decedent delivered to Peter Mangione and Sherwin I. Pogrund, decedent's attorney, a letter stating that although he had not so provided in a codicil to his will executed on that day, it was his desire and wish that Erma be allowed to remain in the condominium unit during her lifetime if she so desired, so long as she paid all of the taxes, liabilities and assessments of the condominium unit.

After decedent's death, Erma filed suit in the Circuit Court of Cook County, Illinois, Probate Division, (herein "State Probate Court") seeking, among other relief, an injunction restraining and enjoining the trustee and beneficiaries of the land trust from interfering with her rent-free use of the condominium unit. By order dated July 7, 1981, the State Probate Court in Erma Mangione v. Peter L. Mangione, et al., case No. 80 P 7214, awarded Erma rent-free use, possession and occupancy of the condominium unit as long as she pays all assessments, real estate taxes, and maintenance and repair charges. Such order further enjoined the trustee and beneficiaries to the land trust

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from interfering with Erma's use, occupancy and possession of the condominium unit. Such order of the State Probate Court did not indicate the reason for its decision and judgment.

On its Federal estate tax return, petitioner elected under section 2032 to value the gross estate as of the alternate valuation date. Such alternate valuation date fell on March 28, 1981. As of March 28, 1981, the value of the condominium unit, without regard to Erma's interest, was $223,650. Petitioner stated the value of the condominium unit on the Federal estate tax return as $223,650 and subtracted therefrom the sum of $147,159 purporting to represent the "restraint on alienation of beneficial interest" resulting from the July 7, 1981 order of the State Probate Court. Petitioner accordingly reported the value of the condominium unit on the Federal estate tax return as $76,491. Respondent issued a statutory notice of deficiency on September 16, 1983, with respect to petitioner's Federal estate tax liability. Therein, respondent determined that the condominium unit should be included in the gross estate at the value of $223,650, without any reduction for Erma's interest, since petitioner had not shown that decedent owned less than an unrestricted 100 percent interest in the condominium unit.

The sole issue is whether for estate tax purposes, the value of the condominium unit should be reduced by reason of Erma's interest therein. As we stated above, contrary to petitioner's position, respondent determined that the value of the condominium

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unit is unaffected by Erma's interest. Petitioner has the burden of proving respondent's determination to be incorrect. Rule 142(a).

The Federal estate tax fixes upon the interest which ceases by reason of decedent's death, rather than the interest to which some person succeeded on death. Edwards v. Slocum, 264 U.S. 61 (1924); Walter v. United States, 341 F.2d 182 (6th Cir. 1965); Mayer v. Reinecke, 130 F.2d 350 (7th Cir. 1942), cert. denied 317 U.S. 684 (1942). Consistent therewith, section 2033 provides that the value of all the property to the extent of decedent's interest therein at the time of death is included in the gross estate. Sec. 2033. The regulations under section 2033 provide that all property benefically owned by decedent at the time of death must be included in the gross estate. Sec. 20.2033-1(a), Estate Tax Regs. Here, the parties have stipulated that decedent owned one hundred percent of the beneficial interest in the condominium unit at the time of his death. Therefore, it follows that one hundred percent of the condominium unit is includible in the gross estate. Petitioner has not argued otherwise. What remains to be decided is the value of such condominium unit for estate tax purposes.

Generally, unless an estate makes an election under section 2032, the value of the property in the gross estate is the value of all property therein at the time of decedent's death. See sec. 2031. Here, petitioner elected to value all property of the gross estate pursuant to the provisions of section 2032. Section

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2032, where relevant herein, provides for the valuation of all the property included in the gross estate as of the date six months after the decedent's death. See sec. 2032(a)(2). Regardless of the election of section 2032, however, the character of the property to be valued is as it existed on the date of death although it is valued at market conditions existing at the elected valuation date. Flanders v. United States, 347 F.Supp. 95 (N.D. Cal. 1972), citing H. Rept. 1885, 74th Cong., 1st Sess. (1939), 1939-1 C.B. (Part 2) 660, 663.

Respondent argues that Erma's interest does not reduce the value of the condominium unit because such interest was either a life estate created by decedent which took effect at decedent's death, or that such interest was created by means of an inter vivos gift with decedent retaining a power to revoke and a life estate in favor of himself. Respondent argues that in either case, the full value of the condominium unit is included in the value of the gross estate for Federal estate tax purposes. Petitioner concedes on brief that if respondent's characterization of Erma's interest is correct, a reduction in the value of the condominium unit by reason thereof would be improper. However, petitioner denies that any life estate in Erma's favor was created or that any inter vivos gift was made by decedent to Erma.

Petitioner premises its entire argument on the theory that Erma had no interest in the condominium unit until July 7, 1981, when a nontransferable, personal interest was created by the

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order of the State Probate Court and that the value of the condominium unit on March 28, 1981, the alternate valuation date, was depressed solely by reason of such interest. On brief, petitioner reasons that such interest reduces the value of the condominium unit as of March 28, 1981, because "[g]iving effect to the July 7, 1981, [State Probate] Court order, the [l]and [t]rust [b]eneficiaries could no longer sell the [c]ondominium [u]nit free from the rent-free use, occupancy, and possession of Erma Mangione in the [c]ondominium [u]nit."[2] Petitioner compares the instant case to one in which stock owned by a decedent is subject to a restrictive buy-sell agreement. Since petitioner has made no other arguments, we will accordingly address only the narrow issue presented by petitioner.

We are bewildered by petitioner's argument. Although we have held that certain restrictions on property play a role in determining fair market value (Estate of Johnson v. Commissioner, 77 T.C. 120 (1981), revd. on another issue 718 F.2d 1303 (5th Cir. 1983)), petitioner has not proved that decedent's one hundred percent beneficial interest in the condominium unit was in any way restricted at the time of his death or on the alternate valuation date. Since petitioner argues that Erma's

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2 Except for its steadfast insistence that the letter of September 15, 1977, was not a codicil to decedent's will and that such letter did not effect an inter vivos gift of an interest in the condominium unit to Erma, petitioner made no attempt to characterize the letter or explain the foundation for the State Probate Court's order awarding the interest to Erma. In any case, there is no indication from the parties that decedent could not have repudiated such letter at any time before his death.

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interest was created on July 7, 1981 and no earlier, we are at a loss to understand how such interest could have affected the value of the condominium unit on the alternate valuation date, some three and one-half months before the day the State Probate Court order which purportedly created such interest was entered. As we stated above, petitioner has asserted on brief that the instant case is similar to one in which stock owned by a decedent is subject to a restrictive buy-sell agreement. Although we recognize that in certain cases the value of stock for estate tax purposes may be affected by a restrictive buy-sell agreement to which the stock was subject at the time of a decedent's death (see, e.g., Estate of Littick v. Commissioner, 31 T.C. 181 (1958)), we find that such cases have no application herein since petitioner has not proved that the condominium unit was subject to any restrictions on transfer either on the date of decedent's death or on the alternate valuation date.

The parties stipulated that the value of such unit on March 28, 1981, without regard to Erma's interest in the property, was $223,650. The value of the condominium unit determined by respondent in the statutory notice of deficiency is also $223,650. We hold that petitioner has failed to prove that the value of the condominium unit for the purpose of its Federal estate tax liability was less than $223,650.

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To reflect concessions and the foregoing,

Decision will be

entered under Rule 155.

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JU 11.7/2:1986-297

T. C. Memo. 1986-297

UNITED STATES TAX COURT

CAROLE L. NASON a/k/a CAROLE L. BALES, Petitioner v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 10796-77. Filed July 21, 1986.

Arnold Ostwald, for the petitioner.

Harvey S. Sander, for the respondent.

MEMORANDUM OPINION

WILBUR, Judge: This case is before the Court on respondent's motion for summary judgment filed pursuant to Rule 121, Tax Court Rules of Practice and Procedure.[1]

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[1] All rule references are to the Tax Court Rules of Practice and Procedure.

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Respondent determined that Carole L. Nason, a/k/a Carole L. Bales (petitioner herein) is liable in the amount of $37,836.75, plus interest as provided by law, as transferee and beneficiary of property of the estate of Davis Bales, deceased.

Some of the facts have been stipulated. The stipulation of facts and the attached exhibits are incorporated herein by this reference. Petitioner was a resident of Jackson Heights, New York, when she filed her petition in this case.

Petitioner and Davis Bales (decedent) were not formally married, but they lived together as husband and wife from 1956 until decedent's death in 1973. When decedent died on November 6, 1973, his estate included a one-half ownership interest in City Buick, Inc. In accordance with his will, petitioner was to receive one-half of the estate and Davis Bales, Jr., son of the decedent, was to receive the other half.

On December 11, 1973, Peter Vallone was named as executor under decedent's will. Petitioner and Davis Bales, Jr. subsequently filed objections to the accounting of the executor in the Queens County Surrogate Court, claiming that Mr. Vallone had been negligent in failing to properly discharge his duties with regard to the estate. On December 18, 1979, petitioner's attorney requested the Queens County Surrogate Court to grant an adjournment so that he could have adequate time to prepare himself for trial. The Surrogate Court denied the request and a

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default decree was ultimately entered against petitioner. As of the date of trial, she has been unsuccessful in her appeal of the default decree.

The decedent's interest in the Buick dealership was valued at $11,000 on the Federal estate tax return filed by the estate. Respondent determined, however, that the fair market value of the estate's interest in City Buick, Inc., as of May 6, 1974, the alternate valuation date, was $401,840. Respondent's notice of deficiency indicates that the executor elected to value the estate as of the alternate valuation date pursuant to section 2032.[2] As a result of respondent's determination that the decedent's 50 percent ownership interest in City Buick, Inc. had been understated, an estate tax of $109,172.35 was assessed against the estate. The executor did not file a petition in this Court in response to the statutory notice of deficiency and the estate tax deficiency was timely assessed.

Petitioner was the beneficiary under a life insurance policy on the life of decedent. On January 23, 1974, petitioner received $37,836.75, consisting of the policy's face value of $45,000 less funeral expenses of $7,163.25. The decedent's estate filed a Federal estate tax return in which the full face value of the policy was included in the gross estate pursuant to section 2042. The only asset received by petitioner as legatee

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[2] All statutory references are to the Internal Revenue Code of 1954, as amended and in effect on the alternate valuation date (May 6, 1974).

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under the decedent's will was the proceeds of this insurance policy. The estate was rendered insolvent upon the transfer of the insurance proceeds to petitioner.

Respondent argues in his motion for summary judgment that, as a result of the transfer of the insurance proceeds, petitioner became a "transferee" within the meaning of section 6901[3] and, as such, became liable for the deficiency in estate tax to the extent of the value of the asset she received.

Section 6901(h) defines a "transferee" to include "any person who, under section 6324(a)(2), is personally liable for any part of such tax." Section 6324(a)(2) provides, in pertinent part, as follows:

> (2) LIABILITY OF TRANSFEREES AND OTHERS.--If the estate tax imposed by chapter 11 is not paid when due, then the spouse, transferee * * * or beneficiary, who receives, or has on the date of the decedent's death, property included in the gross estate under sections 2034 to 2042, inclusive, to the extent of the value, at the time of the decedent's death, of such property, shall be personally liable for such tax. * * *

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[3] Section 6901 provides, in part, as follows:

> (a) METHOD OF COLLECTION.--The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, paid, and collected in the same manner and subject to the same provisions and limitations as in the case of the taxes with respect to which the liabilities were incurred:
>
> (1) Income, Estate, and Gift Taxes.--
>
> (A) Transferees.--The liability, at law or in equity, of a transferee of property--* * *
>
> (ii) of a decedent in the case of a tax imposed by chapter 11 (relating to estate taxes), * * *
>
> in respect of the tax imposed by subtitle A or B. * * *

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Thus, section 6324(a)(2) imposes personal liability on a transferee to the extent that she receives property includable in the decedent's gross estate under sections 2034 to 2042, inclusive. Petitioner concedes that she was the beneficiary of the life insurance policy the face value of which was properly included in the decedent's gross estate pursuant to section 2042.

Respondent argues that this Court should grant his motion for summary judgment because, he asserts, there is no dispute as to the material facts necessary for a finding of transferee liability. If transferee liability is predicated on section 6324(a)(2), respondent must show that (1) the estate tax was not paid when due, and (2) the transferee received property included in the gross estate under sections 2034 to 2042. See Groetzinger v. Commissioner, 69 T.C. 309, 316 (1977); Schuster v. Commissioner, 312 F.2d 311, 315 (9th Cir. 1962), affg. 32 T.C. 998 (1959).

Here the parties have stipulated that the estate tax was assessed against the estate in a timely manner and that no payment of the estate tax deficiency has been made to date. Further petitioner admits that she received the insurance proceeds and that such proceeds were properly included in the decedent's gross estate. Thus, the only issue presented is whether the transferee is foreclosed by a motion for summary judgment from showing that the transferor (the estate) is not liable for all or part of the tax. The transferor's liability

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for the estate tax deficiency turns primarily on the value assigned to the estate's ownership interest in the City Buick, Inc. stock. It is well settled that the determination of value is essentially a question of fact to be decided upon the consideration of all the relevant evidence. McGuire v. Commissioner, 44 T.C. 801 (1965).

We think petitioner, as transferee, has the right under section 6902(a)[4] to show that the transferor was not liable for all or part of the estate tax deficiency previously determined and assessed. Of course, petitioner has the burden of proving that the determination of the estate tax deficiency was erroneous.

In his motion for summary judgment, respondent places great weight on petitioner's answer to a particular interrogatory served on July 23, 1980. In the twelfth interrogatory, petitioner responded in the negative when asked if she thought that the 50 percent interest of Davis Bales in City Buick, Inc. had a value of less than $401,840 as of May 6, 1974. Respondent computed the estate tax for the decedent's estate using the value of $401,840.

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[4] Sec. 6902(a) provides as follows:

(a) BURDEN OF PROOF.--In proceedings before the Tax Court the burden of proof shall be upon the Secretary to show that a petitioner is liable as a transferee of property of a taxpayer, but not to show that the taxpayer was liable for the tax.

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Despite respondent's reliance on petitioner's answer to the twelfth interrogatory, we think the value of the City Buick, Inc. stock as of May 6, 1974 involves a genuine issue of material fact. According to Rule 71, any party may, without leave of Court, serve upon any other party written interrogatories to be answered by the party served. Under Rule 71(c) each interrogatory is to be answered separately and fully under oath. Thus, an interrogatory constitutes evidence similar to that of direct testimony proffered by a witness under oath at trial. This Court is not bound to accept questionable testimony at face value even when it is uncontroverted. Ruark v. Commissioner, 449 F.2d 311, 312 (9th Cir. 1971), affg. a Memorandum Opinion of this Court; Kean v. Commissioner, 51 T.C. 337, 343-344 (1968), affd. on this issue 469 F.2d 1183, 1188 (9th Cir. 1972).[5] The process of valuing stock in a small closely-held corporation that is not listed on any exchange or otherwise traded regularly is a very complex and uncertain one. This is especially so in a falling market similar to the one that existed in the automotive industry during the gasoline crisis in 1973 and 1974.

Generally, assets included in the gross estate are valued at their fair market value immediately after death. Goodman v. Granger, 243 F.2d 264 (3d Cir. 1957). However, the notice of deficiency sent to the Estate of Davis Bales on August 2, 1977,

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5 See also Simon v. Commissioner, T. C. Memo. 1981-198.

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indicates that the executor elected the alternate valuation date pursuant to section 2032.[6] Thus, all assets in the gross estate were to be valued as of 6 months following the decedent's death. With respect to the valuation of the City Buick stock on May 6, 1974, petitioner has consistently taken the position in her action in the New York State courts that the executor acted negligently in allowing the value of the business to drop drastically following her husband's death. It therefore seems inconsistent for petitioner to have conceded the $401,840 value as of 6 months after the decedent's death.

Summary judgment pursuant to Rule 121 corresponds to Rule 56 of the Federal Rules of Civil Procedure and constitutes a procedural mechanism designed to expedite the litigation process. Shiosaki v. Commissioner, 61 T.C. 861 (1974); see the note to

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[6] Section 2032 provides as follows:

> (a) GENERAL.--The value of the gross estate may be determined, if the executor so elects, by valuing all the property included in the gross estate as follows:
> * * *
> (2) In the case of property not distributed, sold, exchanged, or otherwise disposed of, within 6 months after the decedent's death such property shall be valued as of the date 6 months after the decedent's death.
> * * *
> (d) ELECTION.--
> (1) IN GENERAL.--The election provided for in this section shall be made by the executor on the return of the tax imposed by this chapter. Such election, once made, shall be irrevocable.
> (2) EXCEPTION.--No election may be made under this section if such return is filed more than 1 year after the time prescribed by law (including extensions) for filing such return.

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Rule 121, 60 T.C. 1127-1128 (1973). This mechanism, however, should not serve as a substitute for a trial on the merits. The effect of granting this motion would be to decide the controversy against petitioner, as transferee, without permitting her the opportunity for a trial with respect to the estate tax deficiency determined against the transferor, and, therefore, "such motion should be 'cautiously invoked' and only granted after a careful consideration of the case." Shiosaki v. Commissioner, supra at 863.

Rule 121(b) provides that a decision may be rendered on a motion for summary judgment if it is shown "that there is no genuine issue as to any material fact and that a decision may be rendered as a matter of law." The factual materials and the inferences drawn from such materials must be considered in the light most favorable to the party opposing the motion. Heyman v. Commerce and Industry Insurance Co., 524 F.2d 1317 (2d Cir. 1975); Gauntt v. Commissioner, 82 T.C. 96 (1984). Respondent, as the moving party, has the burden of demonstrating that no genuine issue exists as to any material fact, and that he is entitled to a judgment as a matter of law. Adickes v. Kress & Co., 398 U.S. 144, 157 (1970); Gulfstream Land and Development Corp. v. Commissioner, 71 T.C. 587, 596 (1979).

Applying these standards in light of the facts in this record and in a manner most favorable to petitioner, we conclude that a genuine issue of material fact remains with respect to the

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valuation of the decedent's interest in City Buick, Inc. This Court has held that the presence of any reasonable doubt as to the facts at issue will result in the denial of the motion under Rule 121. Hoeme v. Commissioner, 63 T.C. 18, 20 (1974). We emphasize again that in order to avoid transferee liability pursuant to section 6324(a)(2), petitioner will have the burden of proving that the transferor was not liable for the estate tax. Section 6902(a). In the instant case the amount of tax owed will depend primarily on the value placed on the decedent's ownership interest in City Buick, Inc. There is no evidence in the record to indicate the manner by which respondent determined the value of this business interest other than by relying upon petitioner's negative response to an interrogatory. The record indicates merely that what was apparently a valuable asset at the decedent's death fell drastically in value over the course of the administration of the estate.[7]

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7 We note also that there is reason to believe that City Buick, Inc. was liquidated in a bankruptcy proceeding during the course of the estate administration.

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The question of the value of stock in a closely-held corporation is inherently a factual one. Therefore, we decline to decide this case without a full opportunity to observe the parties and their evidence at trial. On this record, we will deny respondent's motion for summary judgment.

An appropriate order will be issued.

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JUII.7/2:1986-298

T. C. Memo. 1986-298

UNITED STATES TAX COURT

LLOYD M. RITLAND AND ELEANOR A. RITLAND, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 23521-82. Filed July 21, 1986.

Robert L. Huffer, for the petitioners.

Rogelio A. Villageliu, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

WILBUR, Judge: Respondent determined the following deficiencies in petitioners' Federal gift taxes:

Quarter Ended	Deficiency
December 31, 1979	$ 2,049.92
March 31, 1980	10,619.04

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At issue is whether the annual gift tax exclusions (totaling $30,000 on each of the gift tax returns filed by petitioners for the calendar quarters in question) should be disallowed in full for the calendar quarter ended December 31, 1979, and reduced to $4,500, for each petitioner, for the calendar quarter ended March 31, 1980.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. The stipulation of facts and attached exhibits are incorporated herein by this reference.

Petitioners Lloyd Ritland (hereinafter Lloyd) and Eleanor Ritland (hereinafter Eleanor), husband and wife, resided in Story City, Iowa at the time the petition was filed in this case. Lloyd and Eleanor have three daughters, each of whom was married during the periods in issue, and four grandchildren. Petitioners' daughter Kia divorced her husband during 1981. Kia has no children.

On December 21, 1979, a "living trust" (hereinafter "the trust") was established by Lloyd and Eleanor. Petitioners' three daughters were named as trustees and primary beneficiaries of the trust. The husbands and issue of petitioners' daughters were named as secondary beneficiaries. The trust instrument gave each daughter and her family a one-third interest in the trust. Income and corpus distributions were allowed at the sole discretion of the trustees, but unanimous approval by the

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trustees was required.[1] The trustees were authorized to withhold any income and principal from a beneficiary and in certain circumstances were required to withhold such from a beneficiary.[2] The trust instrument also allowed the trustees, in their sole

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1 Paragraph II. A. of the trust agreement provided, in part, as follows:

> [T]he Trustees shall hold, administer and distribute the trust property for the sole benefit of the primary and secondary beneficiaries thereof. The principal and income of each said trust may be expended by the Trustees in their sole discretion to or for the benefit of the beneficiaries until they have the trust funds distributed as set out herein. [Emphasis added.]

Paragraph IV. A. of the trust agreement provided, in part, as follows:

> A. Notwithstanding any provision of this instrument, the Trustees may not do any of the following without unanimous approval of all Trustees:
> * * *
> 3) Distribute any income or corpus of the trust.

2 Paragraph VI of the trust agreement provided, in part, as follows:

> If the Trustees believe that the interest of a beneficiary is threatened to be diverted from the purpose for which it was created, the Trustees shall withhold any income and principal which they are authorized to distribute to the beneficiary and shall apply it in such manner as they consider advisable for the care, comfort, maintenance, education or general welfare of the primary beneficiary, her spouse, or issue or other family member. Such distributions to the primary beneficiary or family member may be resumed when the Trustees consider the diversion is no longer effective or threatened.

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discretion, to return income from the trust to the grantors.[3] No provision of the trust instrument actually required that any distribution be made to any beneficiary prior to the termination of the trust. Further, the trust instrument provided that should a primary beneficiary die during the term of the trust, the principal and income remaining in her one-third interest in the trust was to be distributed to whomever she appointed by will.[4]

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3 Paragraph IV. C. of the trust agreement provided as follows:

> C. The Trustees in their sole discretion may return income from the trust to the Grantors if they deem it desirable in their sole discretion.

4 Paragraph II. C. of the trust agreement provided, in part, as follows:

> C. If a primary beneficiary dies during the original or extended term of her trust, the principal and income remaining in her trust at her death shall be distributed:
>
> 1) To her appointee or appointees, including her estate, in trust, or otherwise, as she shall appoint by her will be [sic] specific reference to this power; * * *

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During the periods in issue, petitioners made the following gifts to the trust:

Date	Donor	Type of Asset	Value
Dec. 21, 1979	Lloyd	Farm Property	$163,840
Dec. 21, 1979	Eleanor	Farm Property	143,971
Jan. 3, 1980	Lloyd	Farm Property	94,495

On their gift tax returns for the calendar quarters ended December 31, 1979 and March 31, 1980, petitioners elected to have the above gifts treated as made one-half by each of them. On January 3, 1980, Eleanor also gave $3,000 directly to each of her daughters and their husbands, jointly, for a total gift of $9,000. On their gift tax returns for the calendar quarter ended March 31, 1980, petitioners also elected to have this gift treated as made one-half by each of them. On each of their gift tax returns for the calendar quarters in issue, Lloyd and Eleanor claimed ten $3,000 exclusions, one attributable to each of their three daughters, three sons-in-law, and four grandchildren.

For the years 1980, 1981, 1982, and 1983, the trustees made distributions from trust income. The distributions in each of these years were made in three equal payments to or for the benefit of each of petitioners' daughters or petitioners' daughters and sons-in-law, jointly. Fiduciary income tax returns, Forms 1041, filed by the trustees for these years, however, state that all distributions were made to petitioners' daughters. From the time of their divorce through 1983, the trust made no distributions to Kia's ex-husband.

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OPINION

The only issue in this case is whether petitioners are entitled to the gift tax exclusions which respondent has disallowed.

Section 2503(b)[5], as in effect during the periods in issue,[6] provided for the exclusion of up to $3,000 of gifts (other than gifts of future interests) to any person[7] during a calendar year. Therefore, in order for petitioners to be entitled to these exclusions they must have conferred upon each beneficiary of the trust a present interest worth at least $3,000

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5 Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954, as amended and in effect during the periods in issue.

6 Sec. 2503(b) provided:

(b) EXCLUSIONS FROM GIFTS.--In computing taxable gifts for the calendar quarter, in the case of gifts (other than gifts of future interests in property) made to any person by the donor during the calendar year 1971 and subsequent calendar years, $3,000 of such gifts to such person less the aggregate of the amounts of such gifts to such person during all preceding calendar quarters of the calendar year shall not, for purposes of subsection (a), be included in the total amount of gifts made during such quarter. Where there has been a transfer to any person of a present interest in property, the possibility that such interest may be diminished by the exercise of a power shall be disregarded in applying this subsection, if no part of such interest will at any time pass to any other person. [Emphasis added.]

7 In the case of gifts made in trust, the beneficiary, not the trust or trustee, is the "person" to whom the statute refers. Helvering v. Hutchings, 312 U.S. 393, 396 (1941).

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in each of the calendar quarters in issue. Petitioners concede that the interests of the beneficiaries in the principal of the trust were future interests. Therefore, we must examine the interests of the beneficiaries in the income of the trust to determine the amount, if any, of the present interests conferred upon them. Quatman v. Commissioner, 54 T.C. 339, 341 (1970).

Petitioners contend that the intent of the grantors must be considered in reviewing the trust instrument and that their intent was to give the beneficiaries the present use of the trust income. Petitioners point out that each of the trustees was also a beneficiary and that the trust did, in fact, distribute most of its income on an annual basis. They further contend that the provisions of the trust instrument controlling income distribution do not distinguish between primary and secondary beneficiaries. They conclude that the interests of the beneficiaries in the income of the trust are present interests.

Respondent contends that the requirement of unanimous consent prior to distribution and the trustees' discretion with respect to distributions of income, accumulation of capital, and return of income to the grantors, demonstrate that the gifts in trust were gifts of future interests. Respondent also contends that the gifts are future interests because the number of eventual donees and the value of their gifts are uncertain. We agree with respondent that the gifts in trust were gifts of future interests.

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Section 25.2503-3(a)(b), Gift Tax Regs., defines a present interest in property as "an unrestricted right to the immediate use, possession, or enjoyment of property or the income from property," and defines a future interest in property as "any interest or estate, whether vested or contingent, limited to commence in possession or enjoyment at a future date." See also H. Rept. No. 708, 72d Cong., 1st Sess. (1932), 1939-1 C.B. (Part 2) 478; S. Rept. No. 665, 72d Cong., 1st Sess. (1932), 1939-1 C.B. (Part 2) 526.

In deciding whether a gift made in trust constituted a future interest, the Supreme Court, in Fondren v. Commissioner, 324 U.S. 18, 21 (1945), stated:

> [I]f income is to be accumulated and paid over with the corpus at a later time, the entire gift is of a future interest, although upon specified contingency some portion or all of the fund may be paid over earlier. The contingency may be the exercise of the trustee's discretion, either absolute or contingent. [Emphasis added.]

In a later case, Commissioner v. Disston, 325 U.S. 442, 449 (1945), the Supreme Court explained:

> In the absence of some indication from the face of the trust or surrounding circumstances that a steady flow of some ascertainable portion of income to the [beneficiary] would be required, there is no basis for a conclusion that there is a gift of anything other than for the future. The taxpayer claiming the exclusion must assume the burden of showing that the value of what he claims is other than a future interest. * * *

In Calder v. Commissioner, 85 T.C. 713, 727-728 (1985), we held that Disston "requires the taxpayer to prove three things: (1) That the trust will receive income, (2) that some portion of that income will flow steadily to the beneficiary, and (3) that

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the portion of income flowing out to the beneficiary can be ascertained." It is clear that where distributions are subject to a contingency such as that spoken of in Fondren (i.e., distributions which are contingent upon the exercise of the trustee's discretion), the taxpayer generally will not be able to show that some portion of the income will flow steadily to the beneficiary or that the portion of income flowing out to the beneficiary can be ascertained.

We have found as a fact in this case that the trust instrument did not require the trustees to make any distributions to any of the beneficiaries prior to the termination of the trust. Petitioners assert on brief that it was their intention to give the beneficiaries the present use of the trust's income. Neither the trust instrument nor the testimony of the petitioners at trial, however, indicates that they intended to give the beneficiaries a present right to receive income from the trust.

Petitioners, nevertheless, argue that because income beneficiaries of the trust were named as its trustees, the beneficiaries were in actual control of the trust income. But this argument ignores the fact that unanimous consent by the trustees was required prior to making distributions of the trust income. The requirement of unanimous consent prevents us from finding that any of the beneficiaries had a present interest

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because it cannot be assumed that all three daughters would decide to distribute income to a beneficiary at any particular time or in any ascertainable amount.

A requirement of unanimous consent by beneficiaries of a trust prior to income distributions has previously been held to constitute a "substantial barrier to the donees' present enjoyment" of the income of the trust. Blasdel v. Commissioner, 58 T.C. 1014, 1018-1019 (1972), affd. per curiam 478 F.2d 226 (5th Cir. 1973). In Blasdel, the trustees were required to make periodic distributions of income if such distributions were unanimously approved by the beneficiaries. We held that the requirement of unanimous approval by the beneficiaries prior to distributions was fatal to a finding that the beneficiaries had received present interests in the income of the trust. Blasdel v. Commissioner, supra at 1018. We find the requirement of unanimous approval by the beneficiary/trustees to be similarly fatal in this case.

In addition, the fact that the trust actually distributed most of its income on an annual basis does not affect the status of the beneficiaries' interests. For a donee to have a present interest in gifted property, "he must have the right presently to use, possess or enjoy the property." Fondren v. Commissioner, 324 U.S. 18, 20 (1945) (emphasis added). Petitioners have failed to show that any of the beneficiaries of the Ritland trust have such a right.

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The cases cited by petitioners in support of their position are distinguishable because in each of them the trust instrument required the distribution to the beneficiaries of the net income of the trust at least annually. See Munger v. United States, 154 F. Supp. 417 (M.D. Ala. 1957); Martinez v. Commissioner, 67 T.C. 60 (1976); Quatman v. Commissioner, 54 T.C. 339 (1970); Brown v. Commissioner, 30 T.C. 831 (1958); Swetland v. Commissioner, T.C. Memo. 1978-47.

Accordingly, we hold that the annual exclusions from petitioners' taxable gifts were properly disallowed in full by respondent for the calendar quarter ended December 31, 1979, and reduced to $4,500, for each petitioner, for the calendar quarter ended March 31, 1980, because the gifts made in trust by petitioners were gifts of future interests within the meaning of section 2503(b).

To reflect the foregoing,

Decision will be entered for the respondent.

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COMPLETED JUL 24 1986

JUL 11.7/2:1986-299

T. C. Memo. 1986-299

UNITED STATES TAX COURT

SAMUEL R. HARDING AND DEBORAH B. HARDING, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 22145-84. Filed July 21, 1986.

William A. Diamond, for the petitioners

William Ringuette, for the respondent

MEMORANDUM OPINION

DRENNEN, Judge: Respondent determined the following income tax deficiencies and additions to tax:

Year	Income Tax Deficiency	Additions to Tax Sec. 6653(b) 1/
1979	$3,055.42	$1,527.71
1980	4,520.31	2,260.16

1/ All section references are to the Internal Revenue Code of 1954, as amended, and in effect during the taxable years in question, and all Rule references are to the Tax Court Rules of Practice and Procedure.

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The issues for decision are: (1) whether petitioners are liable for the addition to tax for fraud under section 6653(b) for taxable years 1979 and 1980; and (2) whether the assessment and collection of any taxes and additions to tax for taxable year 1979 is barred by the statute of limitations.

This case was submitted fully stipulated. The stipulations of fact and the exhibits attached thereto are incorporated herein by this reference. The facts related herein were either stipulated or are derived from affidavits of various individuals and memoranda that the parties stipulated into the record and agreed that they could be considered as testimony given in this proceeding.

Petitioners resided in Chester, Virginia during taxable years 1979 and 1980 and at the time they filed their petition herein. Petitioner Samuel R. Harding was employed as an electrical engineer and petitioner Deborah B. Harding was employed as a chemical engineer during the years in question. Petitioners do not have a special tax education or background.

On September 13, 1979, petitioners purchased a charter from Liberty Ministries, International ("LMI"), which established Solar Oriented Life Church ("SOL"), as one of LMI's auxiliary organizations. A packet of literature sent to petitioners from LMI set forth a method by which LMI claimed petitioners could organize an "in-home-church" affiliated with LMI which would qualify as a tax exempt organization under section 501(c)(3).

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Included in the instructional packet was a tax advice letter from William M. Morris, MBA and CPA and an "opinion letter" of Paul Younghanz, CPA. Both letters contained instructions on how to claim deductions for contributions to LMI sponsored "churches." Also included in the packet was a charter for a LMI auxiliary chapter, a certificate of ordination appointing petitioners as ministers of LMI, a letter directing petitioners to serve their LMI chapter by continuing in their present occupations, a constitution and by-laws for establishment of petitioners' LMI auxiliary chapter and sample minutes of board of trustees and board of directors meetings.

Petitioners showed the instructional packet to Mr. James Crawley, an accountant acquainted with petitioners, who prepared petitioners' 1978 income tax returns. Mr. Crawley did not review the material, but told petitioners he had not "heard of this (forming an in-home-church) being done." Petitioners and a Mr. Charles Jacobs signed Articles of Incorporation of SOL dated and notarized November 3, 1979. Petitioners followed substantially all the formalities contained in the documents provided by LMI in organizing SOL as an affiliate of LMI.2/

2/ By letter dated July 22, 1980, LMI's "certification committee" recommended changes in SOL's performance. A "qualification form" outlining LMI's suggestions was not included in the exhibits submitted to this Court. However, after a careful review of the entire record we are satisfied that petitioners complied with substantially all of the qualification standards set forth by LMI.

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In December 1979 petitioners paid $5,200 to SOL by checks drawn on their personal account at First and Merchants National Bank. On or about April 15, 1980, petitioners timely filed a joint Federal income tax return for taxable year 1979 and claimed charitable contributions of $8,797.45 which included the $5,200 payment to SOL and a $3,000 payment to LMI. The $3,000 payment represented the purchase price of the instructional packet and forms produced by LMI. In calendar year 1980, petitioners paid a total of $13,700 to SOL as evidenced by six checks drawn on their personal account at First and Merchants National Bank. On or about April 14, 1981, petitioners timely filed a joint Federal income tax return for taxable year 1980 and claimed charitable contributions of $14,300 which included $13,700 paid to SOL.

Petitioners' payments to SOL were deposited into a bank account established by petitioners in the name of SOL at Southern Bank and Trust Company, Richmond, Virginia. Portions of the money deposited in the SOL account were used to pay personal expenses of petitioners, including payments for electrical and telephone services to petitioners' home, and gasoline for petitioners' automobile. Petitioners knew that funds in the SOL account were used to pay their personal expenses.

Petitioners were first contacted by respondent's agent on or about July 29, 1981, when respondent requested verification of the charitable contributions petitioners claimed on their 1979 and 1980 Federal income tax returns. Petitioners were again

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interviewed by respondent's special agents at their home on November 4, 1981. In that interview, petitioners stated that payments to LMI and SOL were legitimate contributions and that funds contributed to SOL were used strictly for church purposes. Petitioners falsely stated they did not receive any personal benefit from the funds they contributed to SOL. Petitioners agreed to submit their personal records but sought legal advice before releasing records of SOL. After consulting legal counsel, petitioners agreed to provide books and records relating to their personal affairs and those of SOL.3/

From January 1982 to February 1983 respondent's special agents interviewed and obtained statements from petitioners' friends, neighbors and one-time accountant. Respondent issued a statutory notice of deficiency dated and mailed April 5, 1984, wherein respondent disallowed all contributions which petitioners claimed on their 1979 and 1980 Federal tax returns for payments to LMI and SOL.

The founders and officers of LMI gave false and fraudulent advice, instructions, and documents to petitioners on ways to reduce their personal income tax by establishing an in-home-church. In 1984, the founders and officers of LMI were indicted and convicted of violations of United States tax laws in

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3/ Petitioners objected to respondent's summons of the bank records of petitioners' personal accounts and those of SOL but subsequently withdrew their objection on August 11, 1982, on advice of counsel.

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connection with the operation of LMI by the United States District Court for the Eastern District of Virginia, Richmond Division.

Petitioners concede on brief that respondent properly disallowed the deductions for contributions to LMI and SOL. However, petitioners argue that respondent was in error in asserting the fraud penalty under section 6653(b) and that the statute of limitation bars assessment and collection of any tax and additions for taxable year 1979.

OPINION

The first issue is whether petitioners are liable for the addition to tax for fraud under section 6653(b). For purposes of section 6653(b), fraud is an intentional wrongdoing with a specific intent to evade a tax believed to be owed. Stoltzfus v. United States, 398 F.2d 1002, 1004 (3d Cir. 1968), cert. denied 393 U.S. 1020 (1969); McGee v. Commissioner, 61 T.C. 249, 256 (1973), affd. 519 F.2d 1121 (5th Cir. 1975). The existence of fraud is a question of fact to be resolved upon consideration of the entire record. Estate of Pittard v. Commissioner, 69 T.C. 391 (1977); Gajewski v. Commissioner, 67 T.C. 181, 199 (1976), affd. in an unpublished opinion 578 F.2d 1383 (8th Cir. 1978). The burden of proof is on respondent to prove fraud by clear and convincing evidence. Section 7454(a); Rule 142(b). Fraud is not to be imputed or presumed. Beaver v. Commissioner, 55 T.C. 85, 92 (1970); Otsuki v. Commissioner, 53 T.C. 96, 112 (1969).

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Because direct proof of fraudulent intent is seldom available, respondent may show requisite intent from the conduct of the taxpayer and the surrounding circumstances. Grosshandler v. Commissioner, 75 T.C. 1, 19 (1980); Stone v. Commissioner, 56 T.C. 213, 223-224 (1971). However, courts should not sustain findings of fraud upon circumstances which at most create only a suspicion. Davis v. Commissioner, 184 F.2d 86, 87 (10th Cir. 1950).

Respondent argues that petitioners' false statements to respondent's agents on November 4, 1981, "should be sufficient by themselves to sustain the fraud penalty against the petitioners for both of the years involved." We disagree. False statements may be an indicium of fraudulent intent, but we do not find petitioners' statements sufficient to infer fraud in this case. Although not controlling, the memorandum decisions cited by respondent in support of his argument[4/] are clearly distinguishable from the case before us. In those cases, the fraud penalty was imposed against taxpayers whose conduct showed a consistent, regular pattern of making false or misleading

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4/ Respondent also cited an Eighth Circuit decision, United States v. Cohen, 481 F.2d 840 (8th Cir. 1973). The Court of Appeals ruled only on the admissibility of false statements and documents which had a bearing on the question whether the defendant willfully filed a false return under section 7201 and section 7206. The court held that the statements were admissible, but did not address the weight to be given false statements in imposing the fraud penalty under section 6653(b).

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statements to Internal Revenue Service agents.5/ No such consistent or regular pattern exists in the case before us. Furthermore, the false statements made by the taxpayer in each case was only one of several factors the court found demonstrative of taxpayers' fraudulent intent. Although we do not condone such behavior, we are not convinced that petitioners' false statements alone are sufficient to establish fraud.

Respondent next argues that evidence of fraudulent intent can be found in petitioners' decision to proceed with formation of SOL after being told by petitioners' accountant that the in-home-church was a scam. We do not agree with respondent's interpretation of the facts. In his statement stipulated as evidence in this case, petitioners' accountant, Mr. Crawley,

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5/ In Sherman v. Commissioner, T.C. Memo. 1977-261 (1977), taxpayer deliberately lied on four separate occasions to the investigating Internal Revenue Service agent. Taxpayer also denied existence of a bank account later proved maintained by him under a ficticious name. In imposing the fraud penalty under section 6653(b), the Court concluded taxpayer "significantly, systematically, and consistently understated his income." The Court's decision was also based on taxpayers' "maintenance of inadequate and incomplete records" and "consistent pattern of making false statements." In Moore v. Commissioner, T.C. Memo. 1977-275, taxpayer took checks payable to his corporation and deposited them into his personal account in a manner which would conceal the existence of the checks from the corporation's bookkeeper and certified public accountant. In imposing the fraud penalty for understatement of income the Court listed several relevant factors it considered. These included three conflicting stories told to Internal Revenue Service agents by taxpayer in an attempt to identify the source of funds in his personal account. Also mentioned was the fact that taxpayer's conduct was "carefully orchestrated to avoid detection." The Court concluded that the "cumulative weight" of the factors established taxpayer's fraud by clear and convincing evidence.

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stated that a conversation with petitioners led him to the opinion that the in-home-church was a "tax scam." However, the record does not show that Mr. Crawley shared this conclusion with petitioners. Mr. Crawley stated, "He (petitioner Samuel R. Harding), asked me if I knew how he could set himself up as a church, to which I replied I had never heard of this being done. I have had no further conversations with Harding concerning this matter." Respondent failed to further question Mr. Crawley or petitioners about the above referenced conversation. The record is too vague to infer fraudulent intent from this conversation.

Respondent further argues that petitioners no longer used Mr. Crawley to prepare their tax returns because they knew that he would not prepare returns showing charitable contributions to SOL. From this respondent would infer fraudulent intent. However, petitioners offered a reasonable explanation for their decision. Prior to 1978 petitioners prepared their own returns. Petitioners stated they requested Mr. Crawley's assistence in 1978 because they relocated to Virginia from North Carolina and were required to file tax returns in both states. After 1978 petitioners again prepared their own returns. Respondent failed to establish by clear and convincing evidence that an inference of fraudulent intent was justified from petitioners' choice not to use Mr. Crawley's services.

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Furthermore, the evidence indicates that petitioners made no effort to conceal their activities or mislead the respondent concerning their position with regard to LMI and SOL. They appear to have reported their gross income as their own and claimed deductions for the amounts they claim to have contributed to those organizations. While LMI and SOL were not named on petitioners' returns as the recipients of their contributions, respondent had no difficulty in discovering the facts. The bank records were sufficient for that purpose, but it also appears that petitioners were generally cooperative with respondent's agents during the audit. While such disclosure and cooperation does not necessarily disprove fraud, such factors can be given consideration in determining petitioners' intent in failing to report tax on all of their taxable income.6/

We have considered respondent's other arguments but find that respondent has not proved fraud by clear and convincing evidence.7/

6/ See Brennan v. Commissioner, T.C. Memo. 1977-115.

7/ Respondent alleges petitioners may have back-dated incorporation documents of SOL, stating, "one wonders whether or not the minutes (which were not produced to the investigating agents) were not back-dated by the petitioners." As we stated in Davis v. Commissioner, supra, courts should not sustain findings of fraud upon circumstances which at most create only a suspicion.

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The final issue is whether the assessment and collection of any tax for taxable year 1979 is barred by the statute of limitations.

Petitioners timely filed their 1979 Federal income tax return on April 15, 1980. Absent a showing of fraud, the period of assessment for deficiencies expired under section 6501 on April 15, 1983. Respondent issued a statutory notice of deficiency April 5, 1984; almost one year beyond the statutory limit. We have found that respondent failed to prove by clear and convincing evidence that petitioners' returns for 1979 and 1980 were false or fraudulent with intent to evade tax. Consequently, assessment and collection of taxes for taxable year 1979 is barred by the statute of limitations. Section 6501. Assessment and collection of the stipulated underpayment of tax for the taxable year 1980 is not barred by the statute of limitations.

Decision will be entered for petitioners for the year 1979.

Decision will be entered for respondent for the deficiency in tax for the year 1980.

Decision will be entered for petitioners on the additions to tax under section 6653(b) for taxable years 1979 and 1980.

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